

244994

ORIGINAL

**BEFORE THE
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.**

DEPT. OF TRANSPORTATION
DOCKETS

2003 JUN -4 P 4: 17

OST-03-14694-19

In the matter of the

Intra-Alaska Bush Service Mail Rates Case

Docket 14694

**COMMENTS OF THE
CONSOLIDATED CARRIERS
IN RESPONSE TO THE
REQUEST FOR COMMENTS
REGARDING IMPLEMENTATION
OF THE RURAL SERVICE
IMPROVEMENT ACT OF 2002**

Correspondence with respect to this document should be addressed to:

Hank Myers
MTC
Post Office Box 7341
Bellevue, WA 98008-1341

Voice (425) 641-8243
Fax (425) 649-0904
Email hank@mtcworld.com

June 2, 2003

TABLE OF CONTENTS

Introduction	2
First, Report of Insurance Coverage	4
Second, Flight Designation Regulations and Effective Date of First Tender	7
Third, Excise Tax Reporting	16
Excise Tax Collections Not Directly Related to Traffic Volumes	17
The Reporting Requirements Will Be Very Difficult to Meet	18
Excise Taxes are Easier to Manipulate than T-100 Reports	21
Rules for Reporting Standards Must be in Place Before the Beginning Of the Selection Period	23
Fourth, Actions Required to Remain in Tender of Bypass Mail	25
Fifth, Preferential Tender to Part 121 19 Seat Operations	28
Sixth, Application of Part 121 Bush Rates	31
Seventh, Bush Ratemaking Considerations	35
Evolution of Ratemaking Standards	36
General Principles to be Applied	38
Rates Should be Established as Quickly as Possible	39
Rates Adjustment Method Should Accommodate Changes in Service Pattern and Tender	42
Rate Structure Should Adopt Features of Mainline Rates	43
All Carriers and Aircraft Types Must be Included	45
The Current Projection Methodology Must be Continued	46
All Costs Incurred in Qualifying for Mail Tender Must be Included	47
Eighth, Data Retention Requirements	52
Additional Points	53
Proposed Changes in Non-Bypass Mail Tender	53
Proposed Changes in PO-508 Procedures	55
Requests for Preferential Tender	57
No Merger or Consolidation Benefits until November 3, 2004	58
The T-100 Reporting Process is Still in its Infancy	58
Simplicity is the Key to Successful Transition	60
Selection Process for Bypass Mail Pools Begins November 3, 2003	62
Summary	63

**BEFORE THE
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.**

In the matter of the

Intra-Alaska Bush Service Mail Rates Case

Docket 14694

**COMMENTS OF THE
CONSOLIDATED CARRIERS
IN RESPONSE TO THE
REQUEST FOR COMMENTS
REGARDING IMPLEMENTATION
OF THE RURAL SERVICE
IMPROVEMENT ACT OF 2002**

INTRODUCTION

The Consolidated Carriers (hereinafter "Carriers"), a group of certificated carriers operating commercial air service within the State of Alaska, and identified in Appendix A, hereby submits its Comments as requested by the Department. The Carriers group includes 60% of all bush carriers in Alaska. Their routes include all points to which bush bypass mail is dispatched, as well as numerous hubs and points where bypass mail is not transported. The group includes wheel and float aircraft operators, and most of the designated bush Essential Air Service carriers in Alaska. The group includes passenger carriers and all-cargo carriers. As has been the case in the past, the Consolidated Carriers consists of the broadest spectrum of air carriers affected by bush mail rates and

regulations, and represents the unified position of the vast majority of the industry. Some of the constituent carriers will also file Comments of their own to further amplify or explain points of particular interest to them, but there is no contradiction between the points presented here and the individual comments filed by the carriers.

A systematic review of the bush mail rate structure would have been called for at some point anyway, but it is important to remember that the purpose of the current proceeding is to comply with the mandates of the Rural Service Improvement Act of 2002 (“the Act”). The Act contains a number of provisions affecting rural air service, some specific, some vague, and some contradictory. The Department must be guided, and limited by the provisions of the Findings of the Act in determining the correct application of the provisions. It is unrealistic to assume that the provisions of the Act as written will actually achieve the goals enumerated. The law will cause significant dislocation and loss of service to rural Alaska. Passengers, freight shippers and rural mail addressees will all suffer. To meet the goals stated in the Findings, the Department must use its discretion and experience gained from years of regulated and deregulated air service. No state has received more benefit from Airline Deregulation than Alaska. None-the-less, the stated goals of the Act as reflected in its Findings must be respected and incorporated in these proceedings. To that end, the Carriers submit this comprehensive set of recommendations to apply the provisions of the Act in a fair, consistent and timely manner.

First, Report of Insurance Coverage

The requirements in paragraph (k)(4) address the need to have current passenger liability insurance information in order to achieve the goals stated in the Act. Specifically, the Act sets aside 70-75% of bypass mail to support the operations of scheduled passenger service, and provides an additional preference to air carriers operating passenger service with aircraft having 19 insured passenger seats on board. The sole purpose of any additional insurance reporting requirement is to document a carrier's qualification for these preferences. It must be recognized that the vast majority of carriers within Alaska will not seek the 19-seat aircraft preference, and the preference provisions for those aircraft will not take effect for six years.

The Act does not increase the liability limits or change any existing insurance requirement for the air carriers. To that extent, the existing requirements mean that all installed seats are insured. Except for carriers seeking to qualify for preferential tender as a Part 121 passenger carrier with 19 seats installed, current DOT regulations adequately cover the terms of the Act. Because the Act does not set new liability dollar requirements, the only purpose of the require to show the "level of passenger insurance..." is to show compliance with the minimum requirement. The Act does not give additional preferences for higher coverage levels, so there is no need to specify coverage level in excess of the minimum.

Appendix B is a copy of the currently required DOT insurance report. Section 205 of the Department's Economic Regulations requires passenger liability insurance reports to be filed directly by the insurance carrier. §205.3c states: "The certificate of insurance shall list the types or classes of aircraft, or the specific aircraft by FAA or foreign government registration number, with respect to which the policy of insurance applies, or shall state that the policy applies to all aircraft owned or operated by the carrier in its air transportation operations." (emphasis added) §205.4(a) requires "Each carrier shall ensure that the evidence of aircraft liability coverage filed with the Department of is correct at all times." (emphasis added) OST form 6410 specifically lists whether the carrier has passenger or cargo only insurance, and allows the listing of actual aircraft included under the coverage. The form allows the use of additional pages in listing aircraft, which could be used to designate the number of passenger seats insured on each aircraft.

For all-cargo carriers, the existing OST 6410 form is entirely adequate to meet the requirements of §5402(k)(4). For passenger carriers operating aircraft with fewer than 19 insured passenger seat, i.e., not eligible for preferential tender under the terms of the Act, the existing form is entirely adequate. If a carrier wishes to gain preferential tender under the terms of the Act, it is in its own interest to assure that its form 6410 correctly identifies the coverage level and number of insured seats on each eligible aircraft. There is no need to impose additional reporting requirements on carriers for whom there is no need to list number of seats installed.

Appendix C is a copy of the insurance certification required by the State of Alaska for air carriers. This form includes the actual aircraft covered by liability insurance for each carrier. The form is filed directly by the insurance carrier. If the Department should decide that OST form 6410 is not sufficient to meet the goals of the Act, then carriers could simply be required to file a copy of the State of Alaska report.

Administratively, it makes no sense to require duplicative and potentially conflicting insurance reports from the insurance carriers and the airlines themselves. §205 regulations clearly meet the needs of the Act, and the insurance carriers are required under penalty to keep all reports current. Adding a second report, to be filed separately by the air carrier, simply doubles the administrative effort for the carriers and the Department. Furthermore, separate reports create the possibility of conflicting reports. If a carrier fails to file lists of additional aircraft or changes in coverage, the Department will have conflicting data that will have to be resolved. Current reports are filed by the most authoritative source, the insurance carrier.

There is no need for monthly or even regular reports on insurance coverage. Current regulations require that insurance certificates be kept current, and any dates for changes in coverage be clearly stated. It is very easy for the Department, the Postal Service and any interested carrier to determine whether a carrier qualified for preferential tender during any given period. Additionally, nothing in the Act or regulations requires that tender begin or end on particular days or dates. Postal Service fiscal weeks and accounting periods almost never begin on the first of a month. Schedule changes are

frequently filed to be effective at the beginning or ending of Daylight Savings Time or major holidays. It is entirely possible that monthly reports would actually be inadequate to document qualification for preferential tender. The current requirements to specify the effective dates of insurance coverage are the best way to determine qualifications.

As has been noted by other air carriers, service by Part 121 aircraft with 19 passenger seats will be the rare exception rather than the rule. Currently only three carriers operate such aircraft. 19 passenger preferences will never apply to the all-cargo traffic pool, to float operations, to markets where no bypass mail is tendered, or the 68% of bush points that cannot support Part 121 operations (source: Comments of Larry's Flying Service). Carriers wishing to avail themselves of the 19-seat aircraft preference can submit necessary documentation under existing regulations. All other carriers have no need to. The proposed report is duplicative, unduly burdensome to air carriers, and is actually less effective in meeting the goals of the Act than current regulations.

Second, Flight Designation Regulations and Effective Date of First Tender

The proposed routing requirement creates no technical impediment or limitations on the operations of carriers. The *Official Airline Guide*, which creates the schedule data used by the Postal Service for tendering mail, allows the use of a single flight number for circular or "out-and-back" flight, even those that serve the same points more than once. Additionally, it is legal and an accepted practice to cover a single flight movement with more than one flight number in order to accurately list all services provided on the flight.

Air carriers interested in qualifying for tender in the various mail pools can file flight schedules in such a way as to demonstrate compatibility between the T-100 segment data and the T-100 market data.

Historically, carriers have broken flight numbers at intermediate points, or assigned different flight numbers to different segments of a single aircraft movement for internal management purposes. Under current equitable tender practices, the only question was whether the carrier offered at least three flights a week between a dispatch point and a destination. Breaking a single flight into different segments allowed carriers to analyze the profitability of flights, segments and hubs. Revenues and expenses for multi-stop services could be more easily assigned, and the benefit of individual services to the carrier could be more easily determined. Although clearly an unanticipated consequence, the routing changes necessary to maximize mail tender will further complicate the overall management demands for each carrier.

The more important points raised here relate to incorrect assumptions made by carriers and the Department. First, it is clear from the Department's discussion of the topic that the routing problem is far more than hypothetical. The Department not only proposes specific schedule filing formats, but anticipates the need for refilling of traffic reports going back to July 1, 2002. It is vital that before any selection process begins, all carriers understand the implications of various schedule publication schemes and their effect on mail tender.

The rule also illustrates a basic but egregious error in the assumptions upon which the application of the Act lies. The only logical and consistent interpretation of the Act is that the process of selecting the initial group of qualifying carriers begins on November 3, 2003, not that the process ends on November 3, 2003. Selecting carriers is a process of determining which carriers are qualified, not simply a listing of names. The process covers a period of 12 months. The Act clearly states that the sections determining the qualification process shall become effective 15 months after the Act becomes law. The Act assumes or requires certain actions be taken by the Postal Service and the Department before selection can take place, and none of these actions have taken place. As will be pointed out in several sections below, the Act requires carriers to make certain choices and take certain actions in order qualify for bypass mail tender. The time frame required for these carriers to take these actions could not have been completed in time for carriers to be qualified before November 3, 2004. While the Postal Service has announced that it intends to start eliminating carriers from tender in November, that statement is merely a self-serving attempt to enable its own selection process that goes beyond that of the Act.

Part of the deficiency of the Act, and the confusion that must be clarified before the selection process can begin, is that the Act is based on online Origin and Destination traffic, while the T-100 segment data reflect on-flight data. As noted by the Department, current scheduling practices can create conflicts between segment and market reports that are significant. It is the position of the Carriers that the only interpretation consistent

with the clear meaning and goals of that Act is that qualification for mail tender shall be based on online data from the T-100 market reports.

Throughout the history of the Bush mail rates, questions have been raised about the accuracy of data reported by carriers and used to set rates. The primary source of these questions has been the U.S. Postal Service itself, the very agency now proposing to remove tender from carriers based on clearly deficient and incomplete data. Several members of the Carriers have analyzed reports of carriers at several major bush hubs. Their findings confirm the Department's concern about the differences between segment and online data. More importantly, the market reports appear to include traffic not covered by the T-100 program or the intent of the Act. In some markets where market data could be tied to a specific group of flights, it appears that the market traffic reported could not have been physically carried on the flights reported. Part of the problem is in the simplifying assumptions used by the Department in assigning loads and load factors. If an infant in arms is included in the passenger count, it is counted as an adult weight including baggage. If baggage is counted as cargo, it is effectively double counted. There are a number of ways that traffic counts can be manipulated and exaggerated through the T-100 report process. It is vital that the Department assure that reporting standards are understood and being met before any selection process can begin.

While the Carriers oppose the use of excise tax reports, for a variety of reasons, the concern of Congress was that the T-100 reports could be manipulated. The most

effective way to eliminate fraudulent reports is to make sure that all carriers understand the correct method of filing the reports, and to have those reports audited regularly.

Appendix D is a suggested clarification of the T-100 regulations as they apply to the selection process for air carriers. There are no inconsistencies between the Part 241 T-100 reporting process and the Act, but it appears that some carriers are not correctly reporting their data at this time. It is impossible to know whether resubmission of the reports could be accomplished in a timely and accurate fashion. The brief description of the two affected classes of traffic follows.

A revenue passenger is a person who pays a full fare in accordance with an established tariff. The specific language used in the Act is “base fares” (§5402(h)(5)(A)).

Specifically, infants and other persons who do not occupy a paid seat, or from whom no fare is collected shall be excluded from the count. Similarly, persons traveling on carrier business, or who are traveling at free or reduced rates as employees or persons associated with employees, or by virtue of interline pass agreements (written or not), shall not be included as revenue passengers, whether an excise tax is collected on any reduced fare or not. Similarly, any passenger traveling on a free or reduced rate ticket as a result of a contest, prize or promotion offered by the carrier shall not be counted as a revenue passenger. Tour guides, travel agents or other travel professionals traveling at a free or reduced rate, whether or not accompanying revenue passengers, shall be excluded from the count. The collection of excise tax on a ticket is not proof of revenue passenger status. The passenger must pay the full “base fare”.

Any possessions associated with a passenger traveling on a carrier shall be classified as baggage, regardless of how the baggage is charged for. Baggage can move ahead of, with, or after the flight on which the passenger moves. Baggage shall not be included in the freight volume on either the T-100 segment or market reports.

Cargo consists of mail and commercial freight. Commercial freight is material moving on a freight waybill at rates in accordance with an effective tariff, with the shipper and consignee being different persons. Company material, as well as material shipped by company employees, or in accordance with agent agreements or non-revenue traffic shall be excluded.

It is a common practice for carriers to provide free or reduced rate transportation for employees, family members of employees and even friends of employees (“buddy passes”). The transportation of these persons is simply part of the compensation program for employees, and should not be included as revenue passengers. Similarly, carriers routinely provide allowances for a set amount of freight to be moved at free or reduced rates for employees and even firms providing services to the carrier. The Department must assure that these classes of traffic are excluded when determining eligibility for tender.

It is clear that at least some air carriers count baggage as freight in T-100 reports. This gives a distinct advantage to carriers transporting types of passengers that routinely carry large volumes of baggage. River rafters, back-packers, photographers and certain service

employees carry large volumes of baggage in support of their activity. This baggage has no use without the accompanying passenger and must not be included as freight, no matter how the carrier chooses to charge for the transportation. But for the transportation of the associated passenger, the baggage would not be transported either.

The Department can diminish the misstatement of freight traffic by passenger carriers by eliminating any financial incentive. Commercial freight reported by passenger carriers should be excluded entirely from calculations to determine the freight market shares of carriers participating in the all-cargo mail pool. Just as the 20% market share requirement for passengers applies only to carriers competing to carry mail in the passenger pool, the even higher 25% share requirement should apply only traffic of carriers competing to carry mail in the all-cargo pool. This is not only logically consistent with the interpretation of passenger traffic requirements for passenger carriers, it avoids any interference with the operations of all-cargo from passenger carriers. The 25% market share requirement for tender shall be applied only to traffic reporting by carriers in the all-cargo pool.

The Department must maintain active oversight and audits for carriers affected by the Act. In addition to complete audits as have been performed by Department personnel in the past, the Department should perform spot audits to examine samples of data for accuracy. As will be discussed below, the reporting requirements of the Act anticipate a recordkeeping scheme that coordinates flight logs, revenue documents and T-100 reports. This will simplify the task of verifying records from source documents.

For the purposes of enforcing the Act, audits can target markets and carriers where inaccurate reporting would affect mail distribution. For the passenger pool, markets in which a carrier claims 18-30% market share would be the most likely to involve inflated traffic reports. Carriers reporting very high market shares can also enjoy an undeserved reward from traffic inflation because those increases serve to eliminate competitors that would otherwise qualify for a share of mail tender. The Department should also monitor the reported passenger and total load factors on qualifying segments. Load factors that are significantly higher than market average indicate cause for concern.

In establishing the standards for T-100 reports, and to comply with record retention requirements discussed below, the Department should require carriers to maintain a single document or database management system that clearly documents flight operations, aircraft configuration, and the traffic carried on the operation. The document or system must allow an auditor to verify that all traffic reported in the T-100 system is truly revenue traffic and complies with the selection criteria within the Act. A passenger manifest might provide a list of names, but those names must be verified as being revenue passengers purchasing a seat. Similarly, auditors must be able to verify that passenger baggage is not counted as freight, so waybill numbers with clear identification of shipper and consignee must be associated with weight loads reported for particular flights.

As a final comment on the proposed technical requirement for flight listing, it is important to note that Postal requirements for a qualifying schedule include a specific

arrival and departure time for each point served on a flight, and that a flight itinerary list all points in a specific order. No flag stops are allowed, and it is not possible to simply list the intermediate points to be served in a variable manner. Passenger freight and mail traffic in rural Alaska is highly volatile and varies greatly by season, day and even events. Historically, carriers have been allowed to vary their actual flight service from their schedule in order to provide the most efficient or beneficial service to the customers.

The simplest example is the triangular flight pattern that goes A-B-C-A. The most efficient and beneficial way to operate the service on some days may be A-C-B-A, however. If more passengers want to go from A to C, or if more passengers want to backhaul from B to A, it is more efficient and provides better customer service to route the flight A-C-B-A. As long as delivery time requirements to destination Post Offices are met, there is no disadvantage to the Postal Service. Examination of bush carrier passenger and cargo flight schedules shows that the vast majority of points served and flight operated involve clustering of nearby points.

Under the 298 reporting program, changing point order on a flight had no effect on data. The number of departures, hours and miles remain the same or extremely close. In the T-100 system, however, reroutings greatly affect the segment data reports. As will be developed more thoroughly later, the Postal Service has proposed burdensome and potentially punitive reporting requirements that will inhibit the most efficient and beneficial actual flight service in rural Alaska.

Third, Excise Tax Reporting

Virtually all parties agree that the collection of excise tax data will be burdensome, has significant flaws in its correlation with actual traffic, and will add costs to the process of qualifying for and carrying mail. Proponents of the provisions argue that these deficiencies are overcome by the need for some second reference point to verify the accuracy of the T-100 market reports. The irony here is that proponents of excise tax reporting claim it is necessitated by mail tender based on market share. Without market share based tender, there would be no need for a second reporting system.

Despite these clear deficiencies that need to be overcome, the requirement is a distinct part of the Act and its purposes must be recognized. The language clearly requires two steps be taken to comply with the goals of the Act. First, the Department must thoroughly answer the concerns raised by the majority of the carriers about the accuracy and relevance of the excise tax data. As will be shown below, excise tax collections are subject to more variables and potential manipulation than traffic reports. The Department must establish verifiable procedures to ensure accurate reporting, and the ability to use the excise data in a consistent and fair fashion to determine eligibility for tender.

Second, all of the questions must be answered and procedures put in place before any selection process can begin. The Act (§5402(h)(5)(A)(ii)) states: “To ensure accurate reporting of market share, the Postal Service shall compare the resulting percentage under clause (i) to the lesser of [two excise tax calculations specified in under sub-clauses (I)

and (II)].” Whatever forms the final regulations may take, consideration of excise tax data is an absolute requirement for determining tender of bypass mail.

Excise Tax Collections Not Directly Related to Traffic Volumes

Excise taxes are not directly related to traffic in a market. While there is a multiplicity of documents that can be used to verify actual revenue passenger count or revenue freight volume, there is no single tax value for an individual revenue passenger or pound of revenue freight. Excise Taxes, Appendix E, have various rates and elements. The passenger tax consists of two parts, a tax of 7.5% of the applicable fare, and a segment tax of \$3.00 per flight. A passenger traveling from A to C via an online connection at B pays two segment taxes while another passenger flying directly between A and C pays only one. Segment taxes are not applied to certain passengers traveling to or from specifically listed rural destinations or points receiving Essential Air Service subsidy. The huge variation of tax levels legitimately applicable to passenger fares means it will be impossible to develop general standards for credibility of tax or traffic filings.

The 7.5% tax element is paid on the actual fare paid, so that amount varies greatly by carrier, season, routing, and level of competition. This is the amount, for both passengers and freight, which can be manipulated and falsified with ease. For a passenger traveling between two points on a given day there is no single correct excise tax amount. For passengers traveling at different times of year, or via different routings, the variation in excise tax is significant.

The relation of excise tax collections and revenue freight volume in a market is even more distant. There is no tax per pound of commercial freight transported. Taxes are based on actual fees collected. Freight rates per pound in a specific market vary widely depending on total weight of the shipment, the priority the shipper wishes to assign to the movement, whether or not hazardous or dangerous items are included, or any specific commodities. Large but light weight shipments can be charged for on the basis of “dimensional weight”. In fact, many if not most bush freight shipments are subject to a “minimum charge” which is much higher than the actual weight-rate. The same rate would be charged, and excise tax collected, for a one-pound shipment as for a 50 pound shipment. As noted above, it appears that carriers may try to exaggerate their freight volumes by charging for baggage on freight waybills.

The Reporting Requirements will be Very Difficult to Meet

While computer programs exist that could be modified to record excise tax collections by market, direction and traffic type, modification would be costly and time consuming. The primary reason why no systems or procedures exist is that no agency, including the IRS, requires this sort of recordkeeping. All other tax collections are based on units that can be measured directly. The IRS has no requirements to detail or summarize excise tax collections by route, direction, or category of traffic.

While the law is somewhat vague in the coordination of market reports and excise tax collections, it is clear that eligibility for bypass tender is based on a market share in the

outbound direction from the hub. Section (h)(5)(B) states, “Such calculation shall be based only on the carriage of passengers on regularly scheduled flights and only on flights being flown in a direction away from the hub point” (emphasis added). No reason was given in the law why a directional requirement exists. Given the great variation in excise tax collections in relation to traffic carried, all data should be collected in the most consistent manner possible. To that extent, if excise tax reports have to be used at all, they must be tabulated in the same fashion as the T-100 market reports.

Special attention needs to be paid to the question of handling interline and online passenger connections. On interline routings, the excise tax is collected by the ticketing carrier. Typically this is the larger carrier because few bush carriers have ARC ticket stock. This is particularly true for passengers transferring from a larger carrier to a bush carrier flying in a direction away from the hub. The excise tax collected is not prorated among the participating carriers, and the particular destination may be exempt from segment taxes. Similarly, taxes collected on online connections disguise the online origin and destination of traffic. A similar concern applies collection of excise tax data for code-sharing carriers. The carrier actually operating the service is often not the carrier collecting and remitting the taxes.

The importance of determining the relationship between traffic and tax reports cannot be understated. The problem comes from the Act’s requirement to use two disparate and inconsistent measures to make a single determination, who is eligible for mail tender. The dilemma recalls the proverb that says a person with one watch knows what time it is,

but a person with two watches is never sure. It must be anticipated that there will be cases where a carrier has more than 20% of T-100 market traffic, but less than 20% of the associated excise taxes. This could happen if the carrier offers lower fares than its competitors, flies only direct routes to the bush destination, or has a larger proportion of interline tickets than its competitors. All of these characteristics reflect superior customer service, but could be penalized because excise tax collections are less than traffic reports.

It must also be anticipated that there will be situations where a carrier has more than 20% of the traffic and less than 20% of the excise tax collections, while a competitor has less than 20% of the traffic but more than 20% of the tax collections. Would one carrier be tendered bypass and not the other, or would both carriers be tendered, or neither? There is a requirement that the tax reports be made public, just as the traffic reports will be.

The Department and the Postal Service must be able to handle complaints and conflicts over who receives tender in competitive markets. Finally, these disputes will not be limited to carriers with market shares at or near 20% for passenger service and 25% for freight service. The law allows partners in a merger, purchase or consolidation to carry forward and combine their market shares in determining qualification for tender. All carriers' data are subject to question because of the possibility of mergers. The Department faces an enormous and possibly impossible task, but it must address and resolve these problems before the selection process can begin.

Finally, it must be recognized that the sole reason for the collection and analysis of excise tax data is to determine which carriers shall be tendered bypass mail. These reports are

not required by any other agency or for any other purpose. Consequently, the entire costs associated with collecting and reporting these data must be included as a “mail service only” cost in the upcoming bush mail rate proceeding.

Excise Taxes are Easier to Manipulate than T-100 Data

T-100 reports have to be certified by an officer of the airline, and the Act provides serious penalties for falsification of reports. The T-100 reports have a direct link to the base data used to create the reports. It is strange that an additional and inconsistent system of measuring market share would be added. It is even stranger when one considers that the excise tax collections are easier to manipulate than the T-100 statistical reports.

Use of excise tax reports favors carriers with larger aircraft. All operations of aircraft with a maximum gross takeoff weight in excess of 6,000 lbs., including charters, are subject to excise tax. Because the stated purpose of the Act is to support scheduled passenger service, the Department must adjust excise tax reports to exclude operations with over 6,000 lb. aircraft not operating on a published schedule.

Carriers wishing to exaggerate their qualifying traffic could add infants, non-revenue passengers and charter passengers to their reports. For the very small cost of an excise tax payment, their apparent market share would be increased.

Excise tax collections could be used to give legitimacy to shipments of company material, employee freight shipments and baggage as if they were commercial freight. For example, many carriers allow village agents up to 500 lbs. of non-revenue shipping per month. If the carrier added a nominal processing charge for the transportation, say \$5.00 per month, and then taxed that amount (\$0.31), the entire shipment could be made to appear to be a commercial freight shipment. As noted above in the definitions of traffic used in the T-100 reports, all non-revenue traffic should be excluded from consideration. Excise tax collections cannot be allowed to create a loophole for counting this traffic.

Excise tax collections can be used to manipulate the T-100 traffic data. Other techniques can be used to artificially inflate the amount of excise tax collected over a route. One tactic that has been widely used in Alaska is to have directional rates. On a round trip routing, the rate for the segment that is counted in determining market share is priced higher than the reverse direction. This means that more tax is collected in the qualifying direction. Another ploy that has been used in Alaska is to charge a very high passenger ticket price, with a high associated excise tax collection, but include non-aviation services in the price. For example, the ticket price would include a free hotel room, or taxi service, or meal vouchers, phone vouchers, liquor, or even cash rebates. All of these tactics have been used in Alaska and the lower-48 to increase market share.

Excise tax collections are a poor indication of traffic carried, and a poor credibility check for the T-100 reports of bypass carriers. Even if these reports are required for bypass

mail carriers, any excise tax reports should specifically exclude carriers not carrying or desiring to carry bypass mail. In recent meetings in southeastern Alaska, the Postal Service announced that it intends to adopt the same market share criteria used for bypass mail to determine eligibility to carry non-bypass non-priority mail. The move is for the administrative convenience of the Postal Service to minimize computer program development cost. The Act is clear, and the Department must reiterate that any excise tax reporting requirements shall be strictly limited to those carriers desiring to participate in bypass mail tender.

Rules for Reporting Standards Must Be in Place before the Beginning of the Selection Period

The Consolidated Carriers oppose the use of excise tax data either as a primary or confirming source of market share. Collection of the data will be costly, burdensome, and subject to manipulation. Use of a second source of data will inevitably create confusion and conflict, and will add to the already heavy burden of the Department in administering mail rates and monitoring business practices of carriers and the Postal Service. The Carriers encourage the Department to seek elimination of the excise tax data requirement. In the meantime, the Department must establish clear rules relating to the reporting of excise taxes before the beginning of the selection period on November 3, 2003.

The Department should require a single spreadsheet or database that can be audited, which includes all revenue traffic, the excise taxes collected for the traffic, the ticket or waybill document, and the flight logs on which the traffic is carried. Appendix F provides an example of the information that should be included in one place. This report represents a burden on all bypass carriers, but should serve to prevent the greater burdens created by trying to analyze large amounts of uncoordinated data, or having to adjudicate disputes on market share and qualification for tender. Given the potential for misstatements in excise tax reports, it is vital that the tax and traffic reports be consolidated, and references provided to ticket or waybill documents and flight logs. This document would also ease the task of auditing carriers.

An additional certification should be required from all carriers transporting bypass mail. Both the T-100 and excise tax reports should carry a certification that the numbers do not include baggage, non-revenue traffic, company material shipments, prize or promotional tickets or shipments, or non-transport revenue. Carriers currently have no incentive to exaggerate or mis-categorize traffic on T-100 reports. With the new incentives provided by the terms of the Act, the additional certification is necessary to discourage new forms of falsification.

Excise tax reports shall include a separation of operations performed with over 6,000 lb. aircraft. As all operations of over 6,000 lb. aircraft are subject to excise tax, there must be a way to separate scheduled from non-scheduled traffic for these aircraft.

The Department should audit all carriers on a sampling basis to assure compliance with excise and T-100 report requirements. The Department should also hold seminars at regional hubs before putting any new reporting requirements into place to assure understanding of the requirements. The goal should be to eliminate “ignorance” as an excuse.

Fourth, Actions Required to Remain in Tender of Bypass Mail

The section of the Act quoted by the Department is one of the clearest indications that the selection process based on market share shall begin 15 months after the passage of the Act. This section allows carriers a period of 6 months to determine which traffic pool they desire to compete in, and begin concrete actions toward that end. While trying to eliminate carriers not showing concrete evidence of their intent to compete, the section also recognizes that the changes in traffic cannot occur immediately. The Act anticipates a three stage process of implementing its terms. There is a six month period in which carriers can determine how they will respond to the Act. Carriers that show no evidence of wanting to participate can then be removed from bypass tender. Next is a nine month period in which participating carriers can implement any changes in their systems to meet the requirements of the Act. These changes can be as simple as adding or deleting service points, or changing times or routing of existing service. These changes could also involve major changes in operations specifications, adding passenger service, serving new hubs, or adding aircraft. All of these steps take many months to accomplish, and frequently regulatory approval. The final stage of the transition is the first 12-month test

period to determine the initial pool of carriers to be tendered mail in each market and traffic pool.

With regard to implementing 5402(s), it is clear that the only time market share can be used to determine tender is at the end of the 12 month initial test period. This is particularly appropriate because the Act requires use of excise tax data to determine market shares, and no excise tax data exist now or in the foreseeable future. Determining if a carrier is making a good faith effort to comply with the Act should be based on concrete actions taken since the passage of the Act.

Carriers that take significant and concrete actions to comply with the changes in tender brought about by the Act shall not be removed from tender in any market affected by the changes. Furthermore, carriers that already holding the necessary operating authority and are holding themselves out for business consistent with the requirements of the Act shall not be removed from tender because of market share in any market until the end of the initial 12-month test period.

Most bypass carriers in Alaska have had all the authority they need to operate the services in the traffic pool they will participate in. The lack of change in their operating structure cannot be viewed as unwillingness to compete under the new rules.

For carriers that have historically carried little or no passenger or commercial freight traffic, their intent must be measured against concrete actions to qualify for tender.

Among the changes showing intent are changes in operations specifications to allow expanded or improved service. A change in liability insurance coverage is another indication. Purchasing additional or different types of aircraft is a clear signal of intent, as are additions of ground equipment and facilities.

Changes in marketing programs reflect clear intent to compete for market share. Such changes in programs, all of which require lead time, include purchase of Yellow Page ads, media advertising or public promotional efforts, hiring of sales or marketing personnel, upgrades of passenger or freight facilities, or upgrades in administrative or computer services to comply with the provisions of the Act. These actions all cost money or require significant additional effort or expertise by carrier employees.

The intent of this section is to provide an incentive for carriers to take concrete action to participate in their chosen traffic pools, without pre-judging their ultimate chance of success in their venture. A survey of actions taken by carriers at bypass hubs has shown that carriers across the state have expanded or improved their operations specifications, increased insurance coverage, improved passenger and cargo facilities, and upgraded their fleets.

Those carriers have increased the level of active competition for both passengers and freight. Any carrier taking the actions listed above, and others showing similar intent, must not be excluded from bypass mail tender until the end of the qualifying period on November 2, 2004.

Fifth, Preferential Tender to Part 121 19 Seat Operations

The Findings of the Rural Service Improvement Act of 2002 provide very clear direction on this issue. A primary reason for the provisions of the Act is to improve the safety of passenger service by encouraging and rewarding operators that operate Part 121 service with 19 passenger aircraft. The only special tender preference offered to Part 121 carriers is for passenger service with 19 seat aircraft. In determining the applicability and level of the Part 121 rate, only aircraft operated in passenger service with 19 installed passenger seats should be included.

A second issue relating to what markets and service would be covered by the Part 121 rate involves carriers that also operate other aircraft. All precedent, legal and regulatory, requires that mail rates be applied only to the services actually provided. Furthermore, rates cannot be carrier specific for the same market. Indeed, current Postal Service regulations require that a carrier use the aircraft class shown on its published schedule. If a carrier wishes to change aircraft in a way that will affect the mail rate being paid, that carrier must obtain prior permission from the Postal Service. Sections 2-3.2.1.1 and 2-3.2.1.2 of the PO-508 Procedures Manual require that a carrier file a Mail Exception Report (PS form 2734) with the local Postmaster and received prior permission before transferring mail to an aircraft which is of a different class than the one to which the mail was originally tendered. Section 6-2.4.2.3 requires a carrier to report any mail that could not be transported as directed, and follow the instructions of the appropriate officer in transferring or transporting the mail.

Historically and consistently, the Civil Aeronautics Board and Department of Transportation have based rate and tender decisions of service actually provided. Mainline and bush rates were originally determined based on costs of aircraft actually used in the transportation of mail. Mainline rates are adjusted with regard to the amount of mail actually transported on each type of aircraft. The Department has consistently required the Postal Service to pay rates based on service actually provided. Appendix G includes correspondence to and from the Department in which this policy is clearly stated. The Department has also rejected arguments from the Postal Service that aircraft that were in a carrier's fleet but were not used in intra-Alaska mail transportation be included for ratemaking purposes. (Appendix H)

39USC5402 is clearly based on the actual types and classes of aircraft used in the transportation of mail. Eligibility for tender is based on the type of aircraft used, and various hub points are designated for mainline service. All definitions and rate setting procedures included in the Act refer to service actually provided.

Federal Aviation Administration regulations and practices are based directly on the type and class of aircraft actually being employed and service being provided. Parts 91, 121, 125, and 135 apply to distinctly different operations. Each type of operations can be clearly identified as to its governing regulation, and each regulation applies to a distinct and defined type of operations.

Insurance regulations under 14CFR205 are different for charter and scheduled carriers, with further differences between large and small passenger aircraft. While the Department has very clear baggage liability requirements for carriers operating large aircraft, it specifically exempts small aircraft from the requirements. The regulations have clear demarcations and apply the regulations accordingly.

The Rural Service Improvement Act itself sets specific categories of service and specific requirements to qualify for bypass mail tender. Each designation, whether mainline or bush, passenger or cargo service, wheeled aircraft or float aircraft, is clearly distinguished by its own clearly defined characteristics. The Act requires the Department to establish rates of payment consistent with the various categories of service specified in the Act. There is nothing in the Act authorizing or allowing rates paid in a specific market to be different than that for the actual service provided.

With all this clear and consistent precedent, it is ludicrous to contend that payment for mail transportation can be based on anything but actual service provided. It is not legal to pay rates based on the contention that a point could be served by a 19 seat Part 121 aircraft, or that a carrier serving a point provides 19 seat Part 121 service elsewhere. If a point receiving only Part 135 service has an airport that will accommodate Part 121 aircraft, and a carrier that actually operates 19 seat Part 121 aircraft serves that point, it is clear that the point will not financially or safely support 19 passenger Part 121 service. The Part 121 carrier would have made a definite business or operational decision not to serve the point with 19 seat Part 121 aircraft.

Only those markets where 19 seat Part 121 passenger service is actually operated should be covered by the Part 121 rate. There is no need whatever for any listing of Part 121 capable airports. A carrier operating under Part 121 cannot legally serve a point unless it is on its operations specifications and has been subject to proving runs. There is no need for the listing in order to assist the Postal Service in applying its rates. The schedule listing provided to the Postal Service by the *Official Airline Guide* clearly identifies each Part 121 aircraft type to which the Part 121 rate could apply.

The PO-508 requirements are very specific about notifying Postal Service officials in the case of a change in aircraft affecting mail rates. Carriers must receive advance permission to carry the mail on a different class of aircraft, and can be directed to transfer the mail to another carrier. As will be shown below, specific regulations can be imposed that will minimize changes in aircraft that could change mail rates. The proposed airport list is of no value and is unduly burdensome on the carriers involved.

Sixth, Application of Part 121 Bush Rates

The Act and appropriate operating regulations support only one interpretation of the application of Part 121 bush mail rates. The rate shall apply only to mail carried on passenger aircraft operated under Part 121 with 19 installed passenger seats. The only special preference provided for a type or size of aircraft is for Part 121 aircraft with 19 installed passenger seats. The reason stated for this preference is to provide an incentive for carriers to maximize the number of passengers carrying under the higher Part 121

regulations. The Part 121 rate is designed to assure a correct and adequate pay rate for the carriers providing the preferred service. Whether this rate will be higher or lower than other bush rates remains to be determined.

This question again reflects the need to couple rates with service actually provided. It is clear in the legislation, and in the positions taken by various parties since its passage, that how a person wants the Act interpreted depends on what will benefit that person most. Carriers operating 19-passenger Part 121 will argue that they should receive preferences for service operated with less than 19 seats, or even with Part 135 aircraft. The Postal Service will argue whatever position will minimize its costs for mail transportation.

Yet the Act gives overwhelming and consistent weight to the service actually being provided. Carriers must achieve a specific market share in order to receive tender, and that market share is based on specific reports. Heavy penalties are imposed for falsifying the actual results of operations. Only one class of carrier is specifically created and provided preferences in the passenger mail pool, and that is operators actually providing service with Part 121 aircraft with 19 passenger seats installed.

As will be shown below, the creation of the 19 passenger Part 121 mail rate is a result of the creation of that class of tender preference. This position is reinforced by recognizing what the Part 121 rate does not cover. The Part 121 rate does not universally cover any specific make or model of aircraft, application of service, or payload. The Beechcraft 99 is an aircraft that could be operated under Part 121 if all 15 certified passenger seats are

installed, but the aircraft is operated under Part 135 in Alaska. It would never, however, qualify under the 19 passenger Part 121 preference. The Beechcraft 1900 does have 19 passenger seats. When operated with all 19 seats in scheduled passenger service, it is governed by Part 121. Operate the same aircraft and configuration on a charter and it is controlled by Part 135. Run the same aircraft in scheduled passenger service with reduced seating, as is commonly done in Alaska, and it is a 135 aircraft. The 1900 is always operated under Part 135 as a scheduled or charter aircraft in cargo service. The law is very specific about establishing a float plane rate, a Part 135 wheel plane rate, and a Part 121 19 seat aircraft rate. No other rates are mentioned. It defies logic to create a fourth mail rate when the exact same aircraft would be classified in different categories depending on the certification of the airline and the type of service provided.

Given this rate structure and the tender preference given to Part 121 19-passenger aircraft, the Department and the Postal Service must assure that mail is tendered in a fair and consistent fashion. Mail tendered to carriers on the basis of Part 121 19-seat aircraft must only be carried on those aircraft. Mail that cannot be transported by the preferred carrier in the designated aircraft must be transferred to another carrier. A carrier must not be allowed to gain tender through deceptive means or by publishing a schedule it does not have the aircraft to operate.

Aside from the Part 121 19 passenger aircraft, all bush aircraft should be divided into groups of land aircraft and float aircraft. The Department's policy of using class rates to encourage efficient operations is well proven. The Postal Service has long argued that

larger aircraft are more efficient than smaller aircraft. If the Postal Service is correct, including all bush aircraft except Part 121 19 seat aircraft will result in the lowest possible bush rate. The presumed cost efficiencies of these larger aircraft would benefit the Postal Service even at the smallest points where the larger aircraft do not fly. Inclusion of larger aircraft in the general bush rate would result in the lowest possible multi-element rate, and the lowest total cost to the Postal Service for bush mail transportation.

This rate structure is also the easiest system to administer. The same aircraft type would not be divided into two different categories, and complex divisions of reports would not have to be kept. Larger bush aircraft that do not operate under Part 121 would be included in the bush rate paid to all land aircraft. If the Postal Service is correct and these larger aircraft are more efficient, then operators of these aircraft would be given an incentive to expand their use. This is consistent with the goals of the class rate which rewards more efficient carriers and aircraft.

The Act specifically requires development of a three part bush rates as described above. The Act gives the Department discretion on how the rates within each category are set, but does not provide a provision for a fourth subdivision within the rate. The only preferential rates or subdivisions allowed are those specifically enunciated in the Act. It should also be noted that the Act places limitations on equalization between bush and mainline carriers, but there is no limitation placed on equalization of rates among the various categories of bush rates. The Department shall not place any restrictions on

equalization between bush rates, and the Postal Service must recognize all properly filed equalization notices.

Seventh, Bush Ratemaking Considerations

This section is a lengthy discussion of ratemaking procedures and practices. It is hoped that the ratemaking procedures can be set as quickly as possible. The ultimate goal is that new rates be set before the beginning of the carrier selection period on November 3, 2003. The current rate structure has been in effect for approximately 20 years. The first petition for a bush rate structure was filed in 1982, and the Civil Aeronautics Board immediately began the process of collecting data and setting standards. The bush rate standards were based on historic mail ratemaking procedures for larger aircraft, with some adjustments for the smaller aircraft size and data limitations.

The ratemaking process for bush carriers was less sophisticated and accurate than for the mainline rates because of the rudimentary reports then in place and the accounting systems used by the bush carriers. A consistent complaint of the Postal Service, in both mainline and bush proceedings, was that there were not sufficient accurate data to support the conclusions reached by the Department. Increased reporting requirements for bush carriers, and improvements in financial and statistical accounting programs should provide the basis for very accurate rate setting and adjustments. As in previous mail rate cases, regardless of the entity covered, there will need to be some special reports

submitted by the Postal Service and the carriers to identify the relative costs of carrying each type of traffic, and the effect of dispatch practices on those costs.

Evolution of Ratemaking Standards

The current mail rate structure was based on the mandates of the Airline Deregulation Act, as well as then existing procedures for mail handling specified by the Postal Service. Under the two tiered rate structure (mainline and bush) all certificated carriers were eligible for all classes and types of mail in all Alaskan markets. There were no limitations of equalization of rates by bush carriers. Class rate structure covering the entire state with a single rate was adopted to encourage efficient operations. By law, mail rates must be compensatory for the class as a whole, and the rates originally set and subsequently adjusted did and must continue to meet this standard. Bush carriers were paid the same rate for priority and non-priority mail because there were no essential differences in the costs of handling or transporting the two classes of mail. Equitable tender among competing carriers was assumed based on the existing practice of the Postal Service. Equitable distribution has now been mandated by the Rural Service Improvement Act. The C.A.B., and subsequently the Department specifically excluded certain passenger related expenses as being unrelated to the mission of transporting mail. This consisted of "Traffic Related Expense" on the 298 F-2 report. These exclusions included flight attendant expense, passenger liability insurance, passenger marketing expense, credit card fees and head taxes or passenger based fees.

Since the initial setting of the bush rates, there has been several changes in regulations, law and industry practice. There has been a significant increase in the number of bush air carriers, and types of operators. When the initial mail rate proceeding was set, data were gathered from 19 air carriers. This included the vast majority of all bush carriers then certificated. All of these carriers transported passengers as well as freight and mail. Today nearly three dozen bush carriers transport mail under the class mail rate. A new class of carrier, bush all-cargo, has emerged. The list of carriers included in the ratemaking pool has changed dramatically. The vast majority of the carriers that were included in the initial pool are not longer operating as they were, have gone out of business, been sold, or were removed from the pool by Department action.

A major change in mail dispatch and delivery practices resulted from the enactment of the original “Stevens Amendment”. By requiring carriers to have at least 12 months of scheduled operating experience before receiving tender of bypass mail, the costs of qualifying for tender were increased and the competitive pressures among carriers decreased. Postal Service practices were modified to recognize the requirements of the Act, and a third category of mail distribution standards was created specifically for bypass mail. The stated goal of restricting bypass mail to carriers demonstrating a year around commitment to bush service was met, but at an added cost.

The Postal Service modified and increased its requirements for mail handling and delivery, and added staff to enforce the increased standards. These actions improved mail handling and delivery, but also increased carrier costs. A relatively significant

change in FAA regulations took place in 1995. The FAA changed its regulations to require that all multi-engined aircraft used in scheduled passenger service with a seating configuration of 10 passengers seats or more must be operated under FAR Part 121. Previously, aircraft with fewer than 20 passenger seats were regulated under FAR Part 135 regardless of their commercial use. This change was strongly opposed by Senator Ted Stevens, who predicted a reduction in use of 10-19 seat passenger aircraft. The higher cost of operating these aircraft under Part 121 has significantly reduced the number of carriers using them. From the time of the establishment of the bush rate class until 1995, at least 20 different airlines operated 10-19 seats aircraft in scheduled passenger service (although not all at the same time). These aircraft were operated at bases from Barrow to Ketchikan. Today only three carriers operate 10-19 seat aircraft in scheduled passenger service. The upcoming rate setting must also include the effects of the Rural Service Improvement Act, as far as those effects can be quantified.

General Principles to be Applied

It is important that applicable bush mail rates be set as quickly as possible. Mail rates structure is a vital part of carrier decision making, and the new structure and rate (if possible) should be known before the beginning of the 12 month carrier selection period this November. The new rate structure should accommodate changes in tender practices and carrier participants that can be reasonably expected to take place. The division of bypass mail tender into distinct groups, and the eventual preferential tender of some mail

to Part 121 19-passenger aircraft, will shift the mix of carriers and underlying cost structures.

It is suggested that procedures developed in the mainline mail rate case be adopted where feasible. These changes have been evolutionary in the mainline rate, based upon the ability to accurately quantify expenses and mail transport practices. All carriers currently transporting mail should be included in the basic rate calculations. A sample of representative carriers could be used for more detailed studies of cost characteristics, but the results should be applied to a universal pool of carriers. The current method of projecting rates to the covered period should be continued. All costs related to the requirements of the Rural Service Improvement Act must be included in the ratemaking base. The linehaul rate for Part 121 19-seat aircraft can be reasonably estimated by adjusting the costs of appropriate aircraft for any changes related to having 19 seats installed.

Rates Should Be Established as Quickly as Possible

The Department froze bush rates in 2001. This action was taken as a response to the expected passage of what became the Rural Service Improvement Act, and that changes in reporting requirements for certificated Alaskan bush carriers. While the Department noted that it had been some time since a base rate had been set for bush carriers, there was no claim or assumption that bush mail rates were too high. Theoretical arguments were made about possible effects of increased aircraft size and the higher costs of the

larger aircraft, the existing data were not sufficient to document any change from the current rates.

The current group of bush carriers is quite stable. There have been no additions or losses of bush air carriers for some time. No new bush or mainline hubs have been added, and the level of competition and number of carriers participating at each hub has been stable. All of the carriers are experienced in their operations, and the facilities and capital structure are stable.

The overall fleet of aircraft of aircraft in the industry is stable. One additional carrier has purchased twin turbo-prop aircraft, but is not operating them under Part 121. All of the aircraft in the various fleets have been in place for years, and the carriers are operating the aircraft efficiently.

Financial and statistical reporting is stable. The primary financial and expense report used in setting rates, the 298 F-2 report, has been in place for years. Virtually all carriers reporting have been carefully audited by D.O.T. staff. While the T-100 statistical program is not perfect, Alaskan carriers have continued to file the 298 statistical reports. The role of the T-100 reports is relatively minor in any case and deficiencies in those reports will not substantially affect the outcome of the proceeding. If the Department determines to weight carriers in the cost pool by the amount of mail carried, the Postal Service is the best source for those data.

In any initial rate setting process there is a need for more detailed data in order to make cost allocations or weight various activities by use of assets. Topics include analysis of the ground handling costs of various sized aircraft, and the effect of increasing payloads on linehaul costs. The majority of bush carriers now have sophisticated financial and statistical computer programs, particularly those carriers operating larger aircraft.

The Department has established a clear road for setting of rates in Alaska. The questions of rate setting addressed in the bush rate derivation, as well as the mainline rate case, have been well considered and addressed. Even given that there is a need for some additional data on specific points, the Department should begin immediately to set rates for effect by November 3, 2003.

The Carriers suggest a two-stage procedural process. T-100 data and financial reports for the year ended June 30, 2003 should be used to develop and test bush rates within the defined breakdown. Any allocations or special cost subdivisions should also be based on the year ended June 30, 2003.

Appendix I lists special studies that could be useful in setting the various levels of bush rates. The D.O.T. shall make T-100 segment and market data available within 15 days after the due date for June reports, as well as copies of all quarterly reports for all bush carriers for the four quarter through June 30, 2003. It is anticipated that those data would be available to all parties on or about August 25, 2003.

Within 30 days of the dissemination of the financial and statistical reports, parties may propose their mail rates, and justify or explain the elements of their plan. The Department shall issue a Show Cause Order within 30 days of the receipt of the various rate proposals. The Show Cause Order would include the results of the application of data from the 12 months ended June 30, but would also update the rate through September 30, 2003, in accordance with the Department's announced bush rate updating plan. A Final Order would be issued within 30 days of receipt of Answers to the Show-Cause Order. Annual updates would be made on the basis of data for the 12 months ended each September 30.

Rate Adjustment Method Should Accommodate Changes in Service Pattern and Tender

The specific effects of the Rural Service Improvement Act are unclear. While the number of carriers serving each market will be diminished, it is possible that all of the current bush carriers could continue to operate in some fashion. New classes of rates are being proposed, and the mail will be artificially divided among passenger, cargo and other carriers. These pools of mail will change over time as the "other" pool is eliminated. The potential effects of Part 121 19-passenger aircraft preferences are unknown. Finally, the Postal Service has announced a complete revision of its dispatch and reporting requirements resulting from the Act, but has not said what those revisions will be. For all of these reasons, the basic rate and adjustment methods should be able to reflect changes in the industry that will surely occur over time.

The Rate Structure Should Adopt Features of the Mainline Rate

For years the Postal Service contended that mainline and bush mail rates did not accurately reflect the true cost of carrying mail because it did not consider actual distribution and carriage of mail. The Postal Service argued that the mail rate should be weighted on the basis of the actual amount of mail carried by each carrier and aircraft type. The primary difficulty in adopting this process for mainline rates was determining when data were sufficiently accurate for new entrants. The stable industry condition noted above and the effects of the Act will minimize that problem in the foreseeable future.

The advent of the T-100 reporting system has given the Department the tool needed to allocate expenses and traffic by carrier and aircraft type. While it appears that not all carriers are accurately reporting their T-100 data, those deficiencies are easier to resolve than using less detailed data. The Department will have 12 months of data from the T-100 reports from the carriers, as well as market reports and 298 reports for use in verification. As the quality of the T-100 reports improves, so will the accuracy of mail rate adjustments. It is critical that the Department commit adequate effort to ensuring the accuracy of the reports.

As with the setting of the mainline rate and change to a model based on actual mail carriage, there will be a need for supplemental reports from carriers and the Postal Service. Carriers now have sufficient financial and statistical reporting system to support

these analyses. Further, it is the larger carriers that operate the variety of aircraft that could have different cost levels. Smaller carrier usually operate one or two types of aircraft, and in no case operate aircraft with significantly different payloads or flight characteristics. These larger carriers have the ability to provide detailed data necessary to set the rates.

The mainline model more accurately reflects the relationship between passenger, freight and mail traffic. The Act creates an absolute requirement for carriers to participate actively in either passenger or freight carriage in order to qualify for bypass mail tender. The mainline model can be adapted to weight costs in accordance with the mandates of the Act.

The mainline model will automatically adapt to the unknown changes in Postal Service tender policy, as well as eventual changes in carrier service. The problems in adapting to changes in the mainline model have come from carriers being tendered bypass mail before their reporting was up to standard. Under the Act, bush carriers seeking bypass tender will have to file at least one year of compliant reports before they are given bypass tender. The accuracy of reports will precede mail tender.

The same cost considerations applying to bush carriers also applied to mainline carriers at the time of rate setting and adjustments. Some of these considerations were addressed directly in the Act, but the current mainline structure accommodates both passenger and freight carriers in a single structure.

All Carrier and Aircraft Types Must be Included

The original bush rate used a large sampling of carriers to establish the base costs. Carriers were excluded on the basis of small size or questionable reporting capability. The carrier mix used reflected an accurate mix of large and small carriers, as well as geographic diversity. Most important, the carriers selected operated all of the different aircraft types then used in bush mail transportation. Inclusion of a representative mix of aircraft types is even more important than selecting a representative sample of carriers. While there has been a large turnover among bush mail carriers since 1982, the aircraft fleet has remained much more stable.

Virtually all of the currently operating bush carriers have had their financial reporting systems audited by the Department. Based on the findings of the auditor, there is good compliance with financial reporting regulations from top to bottom. The accuracy of the T-100 reports is being sorted out now, but there is no indication that any class or size of carriers are filing more or less accurate results than the industry as a whole.

The mainline model will accommodate a comprehensive and inclusive bush rate study. The mainline rate is a semi-automated model using a spreadsheet. Cost and statistical data are entered for each carrier and the cost allocations are made automatically. The same algorithm will support two carriers, four carriers or 35 carriers. This model also allows setting of rates for different entities in a uniform fashion, and allows for accurate comparison of rates between the entities.

As accurate as the current mainline model is, it is only to be used to adjust base rates set through a comprehensive original study. As with the current bush rate adjustment technique, the mainline adjustment model does not set as new base rate at each change. The setting of the current rate structure, however, should correspond to the update methodology.

The Current Projection Methodology Must be Continued

Under law, mail rates paid to carriers must be compensatory during the period the rates are paid. Historically, the Department analyzed carrier costs for a particular period and ordered a rate retroactive to that period. This resulted in both payments and paybacks for the carriers. The Postal Service did not like the out-of-period cost changes for them, and nobody liked the highly volatile nature of the rate changes.

The Department solved the various problems by adopting least-squares trend lines for linehaul and terminal rates. The unit costs used for adjusting rates became data points in a moving time series of data. Index adjustment factors were projected to the middle of the effective period of the rate. The trend line has resolved the volatility and retroactive payment issues.

By definition, a trend line is not absolutely accurate at any given point in time because it dampens radical changes in rates and carries forward trends to a future period. This is a blessing if moderated change and predictability are valued. Trend lines also reflect

complex changes in an accurate fashion. A number of potential changes are anticipated by various parties, and use of trend line projection to adapt the rate case to any and all actual changes is required.

The accuracy of a trend line, and its response to turning points is based on the number of data points included and time period covered. There is a legitimate concern that using past trend line points will not quickly accommodate the changes anticipated as a result of the Act. The Department can either start an entirely new trend line with the base rate setting, or adjust previous trend line data points to intersect at the new base rate.

Essentially this involves moving the entire series of points up or down until the data point projected from the trend line equals to actual base rate computed by the Department. The Carriers have no position of which technique should be used to establish the future trend line, but suggest that quarterly or semi-annual data points be established for each rate even if rates are actually set annually. This will dampen volatility and identify true turning points in rate trends more accurately.

All Costs Required to Carry or Qualify for Tender of Mail Must be Included in the Mail Rate

The division of costs between linehaul and terminal factors should be continued. This multi-element rate has proven to be the most accurate way to determine rates covering a wide variety of conditions and carriers. When the bush rate was originally set, the only qualification for tender of all categories of bush mail (priority, non-priority, bypass) was

a certificate of public convenience and necessity issued by the Department. There were no external requirements relating to aircraft size, location, type of operation, or type of traffic carried. Once a carrier received a certificate, it was immediately eligible for all types of mail.

In 1988, the passage of the Stevens Amendment placed additional by non-discriminatory requirements on carriers desiring to carry bypass mail. While this delayed dispatch of bypass mail only for new carriers, there were no requirements relating to the type or aircraft, operating rules or type of service provided. An all-cargo carrier operating under Part 135 was entitled to the same consideration as a passenger carrier operating under Part 121. The 1995 revisions to the Amendment had no effect on bush carriers.

The passage of the Rural Service improvement Act, however, creates an entirely new costing model. §5402(h)(6)(A) directs the Secretary to establish a new bush rate, and specifies the divisions in the rate that should be made. §5402(k)(1) requires to Secretary to consider at least every two years the need for a new rate investigation. This would be performed in conjunction with annual updaters of the bush rates. The Act directs the Secretary not to take in account the costs associated with passenger service when updating rates or determining the need for a new rate. This clause, which applies to updates of rates and determining the new for new rates, is meant to exclude passenger cost changes from the determination of rate adjustments or the need for new rates.

A. All Costs Necessary to Qualify for or Carry Mail Must be Included

The base rate established for bush carriers included all costs logically associated with the carriage of mail, and then prorated those expenses by traffic type. Because mail tender did not require the carriage of other types of traffic, costs specifically associated with passengers or freight marketing and handling were excluded. Under the original regulations, mail-only carriers were not excluded. Indeed, these carriers in theory would have the lowest total costs and were closest to the contract mail model.

The Postal Service successfully argued that expenses uniquely associated with generating or handling other categories of traffic should not be included in the mail rate. Cost such as cabin service (flight attendants, food, and beverage service), passenger liability insurance, advertising, credit card fees and promotional expense were excluded from the cost pool used to establish terminal charges.

While it was recognized in theory that there could be cost uniquely associated with mail handled that could be charged entirely to mail service, none were documented in the original rate. The Act, however, creates expenses that are clearly associated only with the transportation of mail, or for qualify for or documenting qualification for mail tender.

The goal of the Act however, is to require that all carriers first establish a significant market share in passengers or freight before being tendered bypass mail in a market. As

will be discussed below, the Postal Service intends to extend this requirement to all mail. Mail will no longer be tendered without regard to other traffic or type of operations.

B. Changes in the Act Must be Reflected in the Cost Pools

In order for a carrier to receive tender in the passenger mail pool, it must have at least a 20% market share of the O&D passengers in that market. In order to carry that level of traffic, a carrier must maintain the required level of passenger insurance. Additionally, it must market and promote its service to the extent necessary to obtain the requisite market share. Unless these expenses are incurred, the carrier receives no tender of mail. To maintain a compensatory mail rate, the Department must include all operating expenses in setting mail rates. To the extent that there are costs unique to the transportation of mail, those expenses shall be removed from the common cost pool and charged entirely to the mail rate.

The various bush rates shall be computed strictly in accordance with the Act. A specific rate shall be set for Part 121 aircraft with 19 passenger seats. All other aircraft shall be divided into wheel and float aircraft and computed accordingly.

Rates paid to carriers shall be based on service actually provided, not service that a carrier is authorized to provide. The Part 121 19-passenger rate in the passenger pool shall not be paid unless a Part 121 carrier provides frequent and consistent 19-seat aircraft service in that market, and all bypass mail tendered at that rate is carried on those aircraft.

Other carriers will have the right to equalize to the lowest rate at their discretion, but if the Part 121 carrier cannot transport mail tendered to it on its 19-seat aircraft, that mail must be transferred to other carriers at the applicable rate. Service provide in Part 135 aircraft must be compensated at the Part 135 rate, regardless of the identity of the carrier transporting the mail.

Linehaul expenses have been prorated on the basis of the weight based portion of the aircraft used by each category of traffic, weighted for boarding priority. The advent of the Act and the availability of the T-100 reports now give the Department a more accurate method of prorating expenses among traffic types. Passenger and freight carriers qualifying for tender on the base of their market share of passengers in a market in the outbound direction from the hub. This probably is specified because that is the primary direction of mail flow. T-100 segment data outbound from the hub shall be used to prorate the linehaul transportation expenses, after adjustment of the weight for boarding priority. For bush rates, the boarding priority for non-priority mail shall be the same as for priority mail.

Costs unique to the handling or transportation of mail should be specifically identified and charged entirely to the mail rate. Example of these costs would be for facilities and equipment used only for the handling of mail, or facility upgrades and security specifically required by the Postal Service. Other costs would be base personnel or village agents whose only compensation is for the transportation or handling of mail.

To the extent a Part 135 carrier is required to convert to Part 121 authority to maintain mail tender, the costs of conversion shall be charged to the Part 121 19-seat aircraft.

In determining the bush mail rates for points served only by water landings, the Department shall set both linehaul and terminal charge rates separate from those of land aircraft. It is clearly recognized that float aircraft fly more slowly, burn more fuel per hour, and have small payloads than their land plane counterparts. Float aircraft are also more difficult to load and generally loaded at a greater distance from the carrier's terminal than land aircraft. The Department must consider differences in departure related expense unit costs between float aircraft and land aircraft. Most float departures are operated by carrier with completely float plane fleets, but the Department may want to seek cost breakouts from carriers that operate both water and land aircraft in mail service.

Eighth, Data Retention Requirements

While the language of the Act pertaining to data retention is similar to that already in effect, the law appears to extend data retention requirements to new documents and sources. The Carriers offer only two suggestions. First, if a carrier maintains computer records of data from original documents, or scanned copies of documents, retention of paper documents should not be required. Second, any additional costs associated with record preparation and retention associated with the Act should be charged entirely to the cost of mail transportation.

Additional Points

Proposed Changes in Non-Bypass Mail Tender

The changes enunciated in the Act are not being applied in a vacuum. The U.S. Postal Service has already begun to enact new requirements on carriers, and plans to request significant changes in data reporting as well. These changes will have a significant impact on carrier qualification and operating costs. Appendix J includes excerpts from a U.S. Postal Service presentation made to carriers in Juneau on May 15, 2003.

In summary, the Postal Service proposes to adopt the bypass tender requirements from the Act and apply them to all mail distribution across Alaska. Distribution of priority and non-bypass non-priority mail will be made only to those carriers having a 20% market share of outbound passengers, or a 25% market share of outbound commercial freight.

These changes can only reduce the amount of scheduled passenger and commercial freight service offered across the State. The law specifically addresses distribution of bypass mail only, and clearly anticipates that all carriers will remain eligible for all other classes of mail. Any requirement related to market share for non-bypass mail will have clearly detrimental results. First, it will make it even more difficult for new carrier to qualify for mail tender because they face the prospect of operating for at least a year without any mail revenue at all. This certainly gives aid and comfort to incumbent

bypass carriers, and eliminates incentive to operate more efficiently as it will be much more difficult to carriers to be displaced from tender.

Second, the proposal includes markets and carriers not affected in any way by the bypass regulations. The primary question is what additional reporting requirements will be imposed on non-bypass carriers? If the Postal Service is going to apply the requirements of the Act, will non-bypass carriers be required to file excise tax data?

Imposition of these rules on non-bypass markets will have the result of reducing service and competition. Non-bypass markets are smaller than bypass markets, and do not have all-cargo service. All scheduled service is offered for both passenger and freight service. If a market is served by three carriers, but only two of them have a 20% market share, the third carrier would be shut out of all mail tender. It would have the option of eliminating service, or going to all-cargo operations. In either case, passengers in these markets will lose service.

The rationale stated by the Postal Service for these changes is that it will reduce programming costs if it can use a single system for dispatching all mail. It can be argued that this is penny wise and pound foolish because it eliminates substantial actual and potential competition. The fact is that this mail distribution policy will affect every non-bypass carrier in the State, and will seriously affect passenger service. The Department must direct the Postal Service to apply historic equitable tender standards for all non-bypass mail

Proposed Changes in PO-508 Procedures

In February, the Postal Service announced that it would be changing its dispatch policies to respond to the provisions of the Act. It provided copies of some changes, which are attached as Appendix K. It is clear that the proposed changes materially exceed the provisions of the Act, and directly contradict existing law and rate orders. As noted above, the Postal Service plans to extend the provisions of bypass tender to non-bypass markets and carriers. In total, the Postal Service is seeking to preempt the provisions of the Act and authority of the Department to set rates and insure fair and open competition.

Of particular concern is a proposal to add separate reporting requirements for carriers that expand on the T-100 data. The Postal Service is proposing that carrier file real time reports showing each individual flight operation. In addition to the data required by T-100 reports, the Postal Service would require specific arrival and departure times at each point. Collection and reporting of these data would be very burdensome and costly, and provide no benefit that is not already available to the Department or the Postal Service. Under the Postal Service's changes, any carrier not complying with the special reporting requirements would be removed from tender, regardless of their qualification under the Act.

The Postal Service rationalizes the requirement for these reports on language that carriers must "exhibit an adherence" to their schedule in mail service. This does not represent a change in any requirement in regulations or law. Indeed, the new requirement is less

strict than the previous language which only required the carrier to adhere to their schedules “to the best of their ability”. There are existing Department regulations relating to unfair or deceptive business practices. Over the years the Department has initiated enforcement proceedings against carriers when there was evidence of unreliable operation. The Act changes nothing in regard to the performance of schedules. It sets no specific standards, and does not provide any mechanism for determining whether a carrier is “exhibiting an adherence to such scheduled flights”. The language in the Act is no different than the language applying to all air carriers under the jurisdiction of the DOT. The requirements are no different for a bypass carrier in Alaska than they are for an all passenger commuter carrier in Florida.

The only entity authorized to take action against a carrier for unreliable performance or unfair or deceptive business practices is the Department. The only provision of removing a carrier from mail tender in the Act is for falsification of T-100 or excise tax reports. Neither of these reports is submitted to the Postal Service, or subject to its authority.

The greatest irony of the proposed reporting requirement is the reason the Postal Service says it is necessary. The Postal Service claims it needs the extensive new reports to determine if the mail is being delivered in a proper fashion. To begin with, the delivery standards under the Rural Service Improvement Act are no more stringent than previously. It must be assumed that current procedures are entirely adequate. Second, the D.O.T. T-100 reports already provide significantly more detail and information than was provided previously, and the detail is provided monthly instead of quarterly. Third,

the Postal Service itself is the best source of information about delivery standards. Its Postmasters are the primary contact point for the Postal Service in each village. In addition, the Postal Service is the first point of contact for complaints about late delivery of bypass mail. Under a new data management system proposed by the Postal Service, they would provide information directly to bypass addressees regarding the delivery of their shipments.

It appears that the Postal Service plans on extending these onerous reporting requirements on all carriers, not simply those that are transporting bypass mail. All non-bypass mail is delivered directly to the destination post office. Clearly the Postal Service is the best authority on whether and when mail is delivered to its own facilities. There is absolutely no need for these intrusive and burdensome reports.

Finally, if the Postal Service does impose any sort of additional reporting requirements based on the provisions of the Act, those cost must be accounted for separately by carriers, and all associated expenses charged directly to the Postal Service in mail rate proceedings.

Requirements for Preferential Tender

One of the clearly stated purposes of the Act is the encouragement of Part 121 passenger service. To that end, the Act calls for an absolute preference for air carriers operating passenger service with 19-seat aircraft. The only way that incentive will work is if it is

applied precisely as stated in the law. To that end, the Department must monitor the Part 121 flights to assure that they have 19 installed passenger seats installed, and that all bypass mail tendered to that carrier is carried on 19-seat aircraft. The Postal Service will also bear the responsibility to assure that any bypass tender is carried only on the qualifying aircraft. Both agencies must prevent carriers claiming preferential tender from using the mail to support non-qualifying aircraft. Mail tendered to preferred services that cannot be transported on the designated aircraft in the specified time shall automatically be transferred to another carrier.

No Merger or Consolidation Benefits can Apply Before November 3, 2004

The act has a specific provision allowing carriers that do not qualify for tender on their own to merge or be bought out and combine their market shares for one year. In order for those provisions to take effect, there must be at least one year of separate market share data upon which the merger could be based. The Postal Service has announced that it intends to update its tender list quarterly, so carriers seeking to consolidate can pick their most advantageous time. The only limit is that there must be at least one year of certified market shares kept before any consolidation can take place.

The T-100 Reporting Process is Still in its Infancy

In Order 2002-1-4, the Department ordered all Alaskan bush carrier to report traffic data in the T-100 reporting format. The data were to be supplied on a “temporary,

experimental basis in order to determine whether the current bush mail rate is accurate.”

The Order further required that “Carriers would continue reporting the old data [298 reports] until it could be determined that they were reliably reporting the new information.” (emphasis added) The Act added the requirement for carriers to submit traffic data using the T-100 diskettes. The Department continues to require the submission of 298 reports, and has made no finding on the reliability or accuracy of the T-100 reports. Analysis by several carriers has shown significant anomalies in the data of some carriers. The most common discrepancy is between the traffic reported on the segment reports when compared with the traffic on the market reports. Some carriers appear to be double counting the number of passengers traveling beyond the first destination point on a routing.

For example, take a flight itinerary of A-B-C-A. The ticketed passengers include:

- 2 passengers A-B
- 3 passengers A-C
- 2 passengers B-A
- 1 passenger C-A
- 8 passengers total

The report should show five passengers on the segment from A-B (two destined for B, three destined for C), five passengers on the segment from B-C (three A-C passengers and two B-A passengers), and three passengers on the segment from C-A (two B-a passengers and one C-A passenger).

It appears that some carriers are combining segment with market passengers on their market reports. For example, some carriers appear to filing for following market data for the flight shown above:

- 5 passengers A-B (the total number of passengers on the segment)
- 3 passengers A-C (the number of passengers ticketed from A-C)
- 5 passengers B-C (the total number of passengers on the segment)
- 2 passengers B-A (the numbers of passengers ticketed from B-A)
- 3 passengers C-A (the number of passengers on the segment)
- 18 passengers total

Ten actual bodies are morphed into 18 passengers reported. Ironically, it appears that the problem in is the setup of the T-100 diskette program. The program requires a carrier to calculate and enter separate numbers for the segment and market data. If the calculations are made incorrectly, or entered inconsistently, then the data are inaccurate. There is nothing wrong with the diskette system if the input is accurate, but the program itself does not correlate the entries between the two reports.

Until the Department determines that all covered carriers are accurately entering and reporting their data in T-100 format, it must be assumed that the existing data are unreliable for selecting carriers.

Simplicity is the Key to Successful Transition and Future Service

As will be seen from the multiplicity of positions on the Act taken by various parties, some of the specific provisions affecting application of the law are vague, unclear and even contradictory. Given the large number of carriers, hubs and destinations covered by the Act, the Carriers strongly request that simple, clear and concise regulations be

adopted. Each regulation should be compared with the Findings of the Act to determine the intent.

The pool of carriers shall be divided between passenger carriers and cargo carriers.

D.O.T. certification, F.A.A. operations specifications, and/or liability insurance coverage will determine which pool each carrier is part of. Passenger shares shall be computed using only the passenger traffic reported by the carriers in the passenger pool in each market. Cargo shares shall be computed using only the non-mail freight traffic reported by the carriers in the cargo pool in each market. Carriers not qualifying for tender within their respective pools would be tendered mail from the 10% pool for as long as that pool exists.

Mail rates shall apply based strictly on the service provided in a market. If a market receives only float plane service, even if there is a paved runway available, then the float plane rate will apply. If a point receives only Part 135 service, regardless of the capability of the airport, the Part 135 rate will apply. There shall be no restriction on equalization right within the bush mail rate. The rate applying to preferential tender to Part 121 19-seat aircraft shall be applied only when the preferential tender comes into effect.

The sole source for the determination of market shares shall be the T-100 market data reports. The Department shall compare the reports to the T-100 segment reports and excise tax reports to determine if the market reports are reliable. If there is a question,

the Department can audit the questionable reports and determine whether the data are accurate. The primacy of the T-100 reports is underscored by the fact that the penalties for falsification of data only apply to the T-100 traffic data.

The Department and the Postal Service should rely on the existing OST insurance forms to determine if a carrier is in the passenger or cargo pool. These reports are required by regulations to be current and accurate, and come from the best authority. When Part 121 19-seat preferences become effective, carriers seeking those preferences can document their aircraft on the existing format.

The Selection Process for Carrier Tender Begins on November 3, 2003

The Act specifies that the sections relating to the selection of carriers become effective on November 3, 2003. The Merriam-Webster dictionary defines “selection” as the process of selecting or choosing. This definition is consistent with the multi-step process required to implement the Act, and the various steps that must be taken by the Department and the Postal Service. The definition and terms of the Act are inconsistent with any interpretation that would set November 3, 2003 as that date on which any carrier would be removed from tender on the basis of market share. To do so would require use of data covering a period beginning before the Act was even passed, and the six month period for carriers to determine their plans.

In a meeting held in the office of Senator Ted Stevens in Anchorage on November 21, 2001, the Senator repeatedly stressed that the purpose of the Act was not to eliminate or target any specific carriers, but to encourage and support passenger and freight service. He repeatedly said that all carriers currently receiving tender would be given a fair opportunity to qualify for tender before any selection was made. In a continuation of the meeting on November 23, 2001, the Senator Stevens' Chief of Staff estimated that it would take 30-36 months to implement the terms of the Act once it was passed. That would give all carriers an opportunity to qualify for mail tender in whichever pool they chose.

As noted earlier, there are no excise tax reports at all, and there is no word or direction from the Treasury Department on the method or form of such filings. The T-100 reports are still of questionable accuracy, particularly for the market reports. Any elimination of carriers from tender before November 3, 2004 would be contrary to the dictates of the Act, and would be arbitrary and capricious actions by the Postal Service.

Summary

The Department has begun its timely and thoughtful consideration of the provisions of the Rural Service Improvement Act of 2002. The Act specifically reserves to the Secretary the ability to set appropriate mail rates, and to collect and validate the accuracy of the T-100 reports which will be used to determine eligibility for bypass tender. At the same time, the Act specifically excludes non-bypass carriers and markets from the

selection process. The Act also adds language requiring and insuring “equitable tender” for all classes of mail in all markets. The Postal Service does not have the authority on its own to disqualify any carriers from mail tender except as described in the Act’s provisions governing bypass mail. Furthermore, the Postal Service does not have the authority to impose new rules, requirements of regulations that are not required to meet the specifications of the Act.

Any actions taken by the Department and the Postal Service must be guided by the Findings of the Act. These Findings include ensuring that residents of rural and isolated communities continue to continue to have affordable, reliable and safe passenger and freight service. The findings go on to support the encouragement of Part 121 where those operations are supported by the needs of the community, and to ensure that the Intra-Alaska Bypass Mail system continues to be used to support substantial passenger and nonmail freight service. The Consolidated Carriers hereby request that its comments, suggestions and recommendations be adopted as written, and that the Department move quickly to implement the Act within the clear meaning of its terms.

Respectfully submitted

The Consolidated Carriers

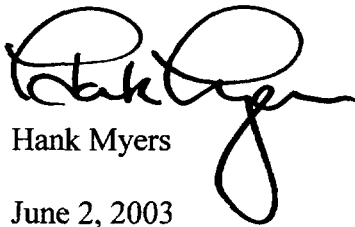
A handwritten signature in black ink, appearing to read "Hank Myers", with a stylized, looping flourish at the end.

By Hank Myers

June 2, 2003

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the Comments of the Consolidated Carriers on the following persons by first mail U.S. Mail at the addresses listed.



Hank Myers

June 2, 2003

R.S. Shreve
Air Transport Association
1301 Pennsylvania Avenue, NW
Washington, D.C. 20004-1701

Robert P. Silverberg
Silverberg, Goldman & Bikoff
1101 30th Street, NW
Washington, D.C. 20007-3708

Thomas L. Albert
Birch, Horton, Bittner & Cherot
1155 Connecticut Avenue, NW
Washington, D.C. 20036

W.P. Bennett, Chief Counsel-Purchasing
U.S. Postal Service – Room 6447
475 L' Enfant Plaza West, SW
Washington, D.C. 20260-0004

Michael VanDamm
Service Counsel
U.S. Postal Service
475 L' Enfant Plaza West, SW
Washington, D.C. 20260-1135

Stuart I. Oran
United Airlines, Inc.
P.O. Box 66100
Chicago, IL 60666-0100

Marshall S. Sinick
Squire, Sanders & Dempsey
1201 Pennsylvania Avenue, NW
Washington, D.C. 20004

Richard P. Taylor
Steptoe & Johnson
1330 Connecticut Avenue, NW
Washington, D.C. 20036-1704

Robert E. Cohn
Shaw, Pittman, Potts & Trowbridge
2300 N Street, NW
Washington, D.C. 20037-1128

Manager, Air Transportation Ops.
U.S. Postal Service
475 L' Enfant Plaza West, SW
Washington, D.C. 20260-0004

James Nawrot
Routing Policy & Networks
U.S. Postal Service – Room 7826
475 L' Enfant Plaza West, SW
Washington, D.C. 20260-7133

Elvia Miller
U.S.P.S. – Air Tansp. Section
P.O. Box 14587
St. Louis, MO 63180-9193

Sam Young
U.S.P.S. – St. Louis Info & Svc. Center
P.O. Box 80193
St. Louis, MO 63180

Orin Seybert
Peninsula Airways, Inc.
6100 Boeing Avenue
Anchorage, AK 99502

Cathy Antush
Era Aviation, Inc.
6160 Carl Brady Drive
Anchorage, AK 99502-1801

Michael Bergt
Alaska Central Express, Inc.
5901 Lockheed Avenue
Anchorage, AK 99502

Michael T. Hart
Lynden Air Cargo, LLC
6441 South Airpark Place
Anchorage, AK 99502-1809

Bruce McGlasson
Grant Aviation, Inc.
P.O. Box 92200
Anchorage, AK 99509-2200

Fred Ciarlo
Tanana Air Service
P.O. Box 60713
Fairbanks, AK 99706-0713

Robert W. Everts
Tatonduk Outfitters, Ltd.
P.O. Box 61680
Fairbanks, AK 99706-1680

Bob Bursiel
Wright Air Service, Inc.
P.O. Box 60142
Fairbanks, AK 99706-0142

William Ayers
Alaska Airlines, Inc.
P.O. Box 68900
Seattle, WA 98168-0900

Judy Johnson
Lynden Air Cargo, LLC
6441 South Airpark Place
Anchorage, AK 99502-1809

Charles Johnson
Era Aviation, Inc.
6160 Carl Brady Drive
Anchorage, AK 99502-1801

Sandra Butler
F.S. Air Service, Inc.
6121 South Airpark Place
Anchorage, AK 99502-1806

W. O'Brien
Era Aviation, Inc.
6160 Carl Brady Drive
Anchorage, AK 99502-1801

Scott Pancoast
Alaska Central Express, Inc.
5901 Lockheed Avenue
Anchorage, AK 99502

Harold Esmailka
Tanana Air Service
P.O. Box 29
Ruby, AK 99768

Karen Wing
Tatonduk Outfitter, Ltd.
P.O. Box 61680
Fairbanks, AK 99706-1680

Art Warbelow
Warbelow's Air Ventures, Inc.
P.O. Box 60649
Fairbanks, AK 99706-0649

Larry Chenaille
Larry's Flying Service, Inc.
P.O. Box 2348
Fairbanks, AK 99707

Michael A. Spisak
Bellair, Inc.
P.O. Box 60311
Fairbanks, AK 99706-0311

James D. Rowe
Bering Air Service, Inc.
P.O. Box 1650
Nome, AK 99762-1650

Robert Jacobsen
Alaska Juneau Aeronautics d/b/a Wings of Alaska
8421 Livingston Way
Juneau, AK 99801

Mike O'Daniel
Skagway Air Service, Inc.
P.O. Box 357
Skagway, AK 99840

Ken Acton
Aviation Consulting & Training
2528 Douglas Drive
Anchorage, AK 99517

Steve Deaton
U.S. Postal Service
P.O. Box 199781
Anchorage, AK 99519-9781

Steve Anderson
Arctic Circle Air Service
P.O. Box 190228
Anchorage, AK 99519-0228

Mike Hageland
Hageland Aviation Services, Inc.
P.O. Box 220610
Anchorage, AK 99522-0610

Grant Thompson
Cape Smythe Air Service, Inc.
P.O.Box 549
Barrow, AK 99723

Donny Olson
Olson Air Service, Inc.
P.O. Box 142
Nome, AK 99762-0142

Allen Haddadi
Bering Air Service, Inc.
P.O. Box 1650
Nome, AK 99762-1650

Layton A. Bennett
L.A.B. Flying Service, Inc.
P.O. Box 272
Haines, AK 99827

Craig Loken
Alaska Seaplane Service, LLC
8995 Yandukin Drive
Juneau, AK 99801

John Eckels
Arctic Transportation Services
5701 Silverado Way, Unit 1
Anchorage, AK 99518-1656

Paul Bowers
Alaska State D.O.T.P.F.
P.O. Box 196900
Anchorage, AK 99519-6900

Don Singsaas
Arctic Circle Air Service
P.O. Box 60049
Fairbanks, AK 99706-0049

Tim LaPorte
Iliamna Air Taxi
P.O. Box 109
Iliamna, AK 99606

Jerry Anderson
Flight Alaska, Inc.
6601 South Airpark Place
Anchorage, AK 99502

Karen Casanovas
Alaska Air Carriers Association
929 East 81st, #108
Anchorage, AK 99518

Marge Baker
Baker Aviation, Inc.
P.O. Box 708
Kotzebue, AK 99752

Scott Cunningham
Smokey Bay Air
P.O. Box 457
Homer, AK 99603

Don King
Village Air Cargo
3944 Spenard Drive
Anchorage, AK 99517

Mike Spernak
Spernak Airways
1707 Merrill Field Drive
Anchorage, AK 99501

Leif Wilson
40 Mile Air
P.O. Box 539
Tok, AK 99780

Robert Hajdukovich
Frontier Flying Service, Inc.
5245 Airport Industrial Way
Fairbanks, AK 99709

Kevin Hack
Promech, Inc.
1515 Tongass Avenue
Ketchikan, AK 99901

Brien Salazar
Venture Travel d/b/a Taquan Air
P.O. Box 8495
Ketchikan, AK 99901

Steve Hill
Inland Aviation, Inc.
P.O. Box 244
Aniak, AK 99557

Sonny Peterson
Katmai Air
4125 Aircraft Drive
Anchorage, AK 99502

Bob Stanford
Redemption Air d/b/a Island Air
P.O. Box 125
Kodiak, AK 99615

Gigi Darby
Servant Air, Inc.
P.O. Box 61186
Fairbanks, AK 99706-1186

INDEX OF APPENDICES

- A. List of Consolidated Carriers Participants
- B. Copy of Form OST 6410
- C. Alaska State Insurance Report
- D. Clarification of T-100 Reporting Standards
- E. Federal Excise Tax Regulations
- F. Excise Tax / T-100 Report Coordination Form
- G. Correspondence Relating to Rate Paid for Service Actually Provided
- H. D.O.T. Order Rejecting Use of Aircraft Not Used in Mail Transport
- I. Special Cost Studies for Rate Development
- J. Postal Service Presentation on Non-Bypass Mail Tender Procedures
- K. Proposed PO-508 Changes

LIST OF CONSOLIDATED CARRIERS PARTICIPANTS

Alaska Seaplane Service

Baker Aviation

Bellair, Inc.

Cape Smythe Air Service

Grant Aviation

Iliamna Air Taxi

Island Air Service

Katmai Air

L.A.B. Flying Service

Larry's Flying Service

Olson Air Service

Servant Air

Skagway Air Service

Smokey Bay Air

Tanana Air Service

Taquan Air Service

Wings of Alaska

Wright Air Service



U.S. Department of
Transportation
Office of the Secretary
of Transportation

AGENCY DISPLAY OF ESTIMATED BURDEN

The public reporting burden for this collection of information is estimated to average 30 minutes per response. If you wish to comment on the accuracy of the estimate or make suggestions for reducing this burden, please direct your comments to the Department of Transportation at the following address:

U.S. Department of Transportation
Office of Aviation Analysis, X-56
400 7th Street, SW.
Washington, DC 20590

OMB No. 2105-0030 Expires 2-28-01

U.S. AIR CARRIERS
CERTIFICATE OF INSURANCE

POLICIES OF INSURANCE FOR AIRCRAFT ACCIDENT BODILY INJURY
AND PROPERTY DAMAGE LIABILITY

FILING INSTRUCTIONS: File an original of this form with the FAA, Air Transportation Div., AFS-200, 800 Independence Ave., SW., Washington, DC 20591.
NOTE: If Block 2B on the reverse is filled in because the insured is an air taxi operator conducting scheduled passenger service (i.e., a commuter air carrier), file an original of this form with the Air Carrier Fitness Div., X-56, Office of Aviation Analysis, Dept. of Transportation, 400 7th St., SW., Washington, DC 20590.

(Please type information, except signatures.)

THIS CERTIFIES THAT: _____
(Name of Insurer)

has issued a policy or policies of Aircraft Liability Insurance to _____

_____ FAA Certificate Number _____
(Name, address and FAA Certificate number of insured U.S. Air Carrier)

effective from _____ until ten (10) days after written notice from the insurer or carrier of the intent to terminate coverage is received by the Department of Transportation.

NOTE: Part 205 of the Department's Regulations does not allow for a predetermined termination date, and a certificate showing such a date is unacceptable.

1. The Insurer (Check One):

- ☐ is licensed to issue aircraft insurance policies in the United States;
☐ is licensed or approved by the government of _____ to issue aircraft insurance policies; or
☐ is an approved surplus line insurer in the State(s) of _____

2. The insurer assumes, under the policy or policies listed below, aircraft accident liability insured to minimums at least equal to the following during operation, maintenance, or use of aircraft in "air transportation" as that term is defined in 49 U.S.C. 40102.

(Complete applicable section(s) below):

A. U.S. AIR TAXI OPERATORS WITH PART 298 AUTHORITY ONLY

The aircraft covered by this policy are SMALL AIRCRAFT (i.e., with 60 or fewer passenger seats or with a maximum payload capacity of 18,000 pounds or less). (Check separate or combined coverage as appropriate):

☐ Separate Coverages:

Policy No.	Type of Liability	Minimum Limit	
		Each person	Each Occurrence
_____	Bodily Injury Liability (Excluding Passengers)	\$ 75,000	\$300,000
_____	Passenger Bodily Injury	\$ 75,000	\$75,000 x 75% of total number of passenger seats installed in aircraft
_____	Property Damage		\$100,000

- ☐ Combined Coverage: This combined coverage is a single limit of liability for each occurrence at least equal to the required minimums stated above for bodily injury (excluding passengers), property damaged, and passenger bodily injury.

Policy No. _____ Amount of Coverage _____

- ☐ This policy covers CARGO operations only and excludes passenger liability insurance.

B. U.S. COMMUTER AND CERTIFICATED AIR CARRIERS OPERATING SMALL AIRCRAFT The aircraft covered by this policy are SMALL AIRCRAFT (i.e., with 60 or fewer passenger seats or with a maximum payload capacity of 18,000 pounds or less). (Check separate or combined coverage as appropriate):																	
<input type="checkbox"/> Separate Coverages: <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 5px;"> <thead> <tr> <th rowspan="2">Policy No.</th> <th rowspan="2">Type of Liability</th> <th colspan="2">Minimum Limit</th> </tr> <tr> <th>Each person</th> <th>Each Occurrence</th> </tr> </thead> <tbody> <tr> <td>_____</td> <td>Combined Bodily Injury (Excluding Passengers other than cargo attendants) and Property Damage Liability</td> <td>\$300,000</td> <td>\$2,000,000</td> </tr> <tr> <td>_____</td> <td>Passenger Bodily Injury</td> <td>\$300,000</td> <td>\$300,000 x 75% of total number of passenger seats installed in aircraft</td> </tr> </tbody> </table>				Policy No.	Type of Liability	Minimum Limit		Each person	Each Occurrence	_____	Combined Bodily Injury (Excluding Passengers other than cargo attendants) and Property Damage Liability	\$300,000	\$2,000,000	_____	Passenger Bodily Injury	\$300,000	\$300,000 x 75% of total number of passenger seats installed in aircraft
Policy No.	Type of Liability	Minimum Limit															
		Each person	Each Occurrence														
_____	Combined Bodily Injury (Excluding Passengers other than cargo attendants) and Property Damage Liability	\$300,000	\$2,000,000														
_____	Passenger Bodily Injury	\$300,000	\$300,000 x 75% of total number of passenger seats installed in aircraft														
<input type="checkbox"/> Combined Coverage: This combined coverage is a single limit of liability for each occurrence at least equal to the required minimums stated above for bodily injury (excluding passengers), property damaged, and passenger bodily injury. Policy No. _____ Amount of Coverage _____																	
<input type="checkbox"/> This policy covers CARGO operations only and excludes passenger liability insurance.																	
C. U.S. CERTIFICATED AIR CARRIERS OPERATING LARGE AIRCRAFT The aircraft covered by this policy are LARGE AIRCRAFT (i.e., with more than 60 passenger seats or with a maximum payload capacity of more than 18,000 pounds). (Check separate or combined coverage as appropriate):																	
<input type="checkbox"/> Separate Coverages: <table border="1" style="width: 100%; border-collapse: collapse; margin-top: 5px;"> <thead> <tr> <th rowspan="2">Policy No.</th> <th rowspan="2">Type of Liability</th> <th colspan="2">Minimum Limit</th> </tr> <tr> <th>Each person</th> <th>Each Occurrence</th> </tr> </thead> <tbody> <tr> <td>_____</td> <td>Combined Bodily Injury (Excluding Passengers other than cargo attendants) and Property Damage Liability</td> <td>\$300,000</td> <td>\$20,000,000</td> </tr> <tr> <td>_____</td> <td>Passenger Bodily Injury</td> <td>\$300,000</td> <td>\$300,000 x 75% of total number of passenger seats installed in aircraft</td> </tr> </tbody> </table>				Policy No.	Type of Liability	Minimum Limit		Each person	Each Occurrence	_____	Combined Bodily Injury (Excluding Passengers other than cargo attendants) and Property Damage Liability	\$300,000	\$20,000,000	_____	Passenger Bodily Injury	\$300,000	\$300,000 x 75% of total number of passenger seats installed in aircraft
Policy No.	Type of Liability	Minimum Limit															
		Each person	Each Occurrence														
_____	Combined Bodily Injury (Excluding Passengers other than cargo attendants) and Property Damage Liability	\$300,000	\$20,000,000														
_____	Passenger Bodily Injury	\$300,000	\$300,000 x 75% of total number of passenger seats installed in aircraft														
<input type="checkbox"/> Combined Coverage: This combined coverage is a single limit of liability for each occurrence at least equal to the required minimums stated above for bodily injury (excluding passengers), property damaged, and passenger bodily injury. Policy No. _____ Amount of Coverage _____																	
<input type="checkbox"/> This policy covers CARGO operations only and excludes passenger liability insurance.																	
3. The policy or policies listed in this certificate insure(s) (Check One):		Make and Model _____	FAA or Foreign Flag Registration No. _____														
<input type="checkbox"/> Operations conducted with all aircraft operated by the insured <input type="checkbox"/> Operations conducted with the following types of aircraft: <input type="checkbox"/> Operations with the following aircraft: (Use additional page if necessary)																	
4. Each policy listed in this certificate meets or exceeds the requirements in 14 CFR Part 205.																	
(Name of Insurer) _____		(Name of Broker, if applicable) _____															
(Address) _____		(Address) _____															
(City, State, Zip Code) _____		(City, State, Zip Code) _____															
Contact (person who can verify the effectiveness of the coverage) _____		(Officer or authorized representative) _____															
(Area Code, Phone Number) _____	(Area Code, Fax Number) _____	(Area Code, Phone Number) _____	(Area Code, Fax Number) _____														
(Signature, if applicable) _____		(Signature) _____															
(Date) _____		(Date) _____															

STATE OF ALASKA

AIR CARRIER CERTIFICATE OF COMPLIANCE

Certificate No. 03-276

Expires: November 20, 2003

WRIGHT AIR SERVICE, INC.


HAS MET THE REQUIREMENTS OF AS 02.40.010 AND AS 02.40.020 PERTAINING
TO AIR CARRIER FINANCIAL RESPONSIBILITY OF \$150,000 PER SEAT FOR
BODILY INJURY OR DEATH IN A SINGLE OCCURRENCE AND \$100,000
FOR PROPERTY DAMAGE IN A SINGLE OCCURRENCE FOR THE FOLLOWING

FAA NUMBER	PASSENGER CONFIGURATION	FAA NUMBER	PASSENGER CONFIGURATION
N1323R	9	N4365U	9
N540ME	9	N32WA	9
N4437U	4	N73463	4
N6445V	3	N54WA	8
N9FW	8	N7426L	6
N6478V	3	N900WA	9

THIS CERTIFICATE MUST BE VISIBLE TO ALL BOARDING PASSENGERS

Issue Date: Monday, April 14, 2003

ISSUED BY:


Air Carrier Compliance Program Manager

DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES
DIVISION OF STATEWIDE AVIATION
P.O. BOX 108800
ANCHORAGE, ALASKA 99510-8800

Clarification of T-100 Reporting Standards

For the purposes of clarifying the data to be entered as Revenue Traffic in the T-100 segment and market, the following summary suggests those items to be included and excluded from the count.

Passengers

Only passengers paying a fare available to the general public in accordance with a published tariff shall be included in the Revenue Passenger count. The count shall specifically exclude, for example, children for whom no passenger seat was purchased, employees who are traveling on company business, persons to whom free or reduced rate travel has been granted in conjunction with the business needs of the carrier, employees and guests traveling on free or reduced rate tickets for any purpose, persons for whom transportation is provided for free or on a reduced rate as part of a contest, promotion or charitable or other contribution, travel agents or tour guides traveling at free or reduced rates, law enforcement officials traveling at free or reduced rates, employees of the F.A.A. or any other government agency traveling at free or reduced rates, and flight crews of any carrier deadheading on the lines of the reporting carrier. This list of persons to be excluded is not exhaustive, but merely illustrative of the types of persons who would not be counted as revenue passengers.

Baggage

Baggage consists of property of a passenger traveling on the carrier, and having the same origin and destination as the passenger. Baggage may move before, after or at the same time as the passenger involved. Baggage shall be entirely excluded from the T-100 reports regardless of how the baggage has been charged for. For the purposes of reporting, there is no difference between free baggage and baggage for which a charge is applied. Baggage which is charged for at freight rates is still baggage, and shall not be included as revenue freight on the T-100 reports.

Freight

Freight is non-mail property not accompanying or associated with a passenger movement. Freight consists of property shipped in accordance with a published tariff available to the general public, with a different shipper and consignee. Waybills with the same shipper and consignee are assumed to cover baggage shipments. Revenue freight shall exclude, among other items, property that is company material, or is being transported at free or reduced rates for an employee or agent. Property that is transported for consideration other than cash (trade-outs) shall be excluded. Property shipped as a part of an agency or employment agreement, written or not, shall be excluded.



Department
of the
Treasury
Internal
Revenue
Service

Publication 510
(Rev. February 2003)
Cat. No. 15014I

Excise Taxes for 2003



**Get forms and other information
faster and easier by:**

Computer • www.irs.gov or FTP • [ftp.irs.gov](ftp://ftp.irs.gov)
FAX • 703-368-9694 (from your FAX machine)

Contents

Important Changes	2
Important Reminders	2
Introduction	2
Excise Taxes Not Covered	2
Registration for Certain Activities	2
Environmental Taxes	2
ODCs	3
Imported Taxable Products	3
Floor Stocks Tax	4
Communications and Air Transportation Taxes	4
Communications Tax	4
Air Transportation Taxes	5
Fuel Taxes	7
Information Returns	8
Registration Requirements	8
Refunds of Second Tax	8
Definitions	8
Gasoline	9
Gasohol	11
Diesel Fuel and Kerosene	12
Aviation Fuel	16
Special Motor Fuels	17
Compressed Natural Gas	18
Fuels Used on Inland Waterways	18
Alcohol Sold as Fuel But Not Used as Fuel	19
Manufacturers Taxes	19
Taxable Event	20
Exemptions	20
Credits or Refunds	20
Sport Fishing Equipment	21
Bows	21
Arrow Components	21
Coal	21
Tires	22
Gas Guzzler Tax	22
Vaccines	23
Retail Tax on Heavy Trucks, Trailers, and Tractors	23
Ship Passenger Tax	26
Foreign Insurance Taxes	26
Obligations Not in Registered Form	27
Filing Form 720	27
Paying the Taxes	27
Credits and Refunds	29
Tax on Wagering	29
Penalties and Interest	30
Examination and Appeal Procedures	30
Rulings Program	30
How To Get Tax Help	31

not included in any group is based on the charge for each item separately. Do not include in the tax base state or local sales or use taxes that are separately stated on the taxpayer's bill.

If the tax on toll telephone service is paid by inserting coins in *coin-operated telephones*, figure the tax to the nearest multiple of 5 cents. When the tax is midway between 5-cent multiples, the next higher multiple applies.

Prepaid telephone cards. A prepaid telephone card is any card or any other similar arrangement that allows its holder to get local or toll telephone service and pay for those services in advance. The tax is imposed when the card is transferred by a telecommunications carrier to any person who is not a telecommunications carrier. The face amount of the card is the amount paid for communications services. If the face amount is not a dollar amount, see section 49.4251-4 of the regulations.

Exemptions

Payments for certain services or payments from certain users are exempt from the communications tax.

Installation charges. The tax does not apply to payments received for the installation of any instrument, wire, pole, switchboard, apparatus, or equipment. However, the tax does apply to payments for the repair or replacement of those items incidental to ordinary maintenance.

Answering services. The tax does not apply to amounts paid for a private line, an answering service, and a one-way paging or message service if they do not provide access to a local telephone system and the privilege of telephonic communication as part of the local telephone system.

Mobile radio telephone service. The tax does not apply to payments for a two-way radio service that does not provide access to a local telephone system.

Coin-operated telephones. The tax for local telephone service does not apply to payments made for services by inserting coins in public coin-operated telephones. The tax for toll telephone service also does not apply if the charge is less than 25 cents. But the tax applies if the coin-operated telephone service is furnished for a guaranteed amount. Figure the tax on the amount paid under the guarantee plus any fixed monthly or other periodic charge.

Telephone-operated security systems. The tax does not apply to amounts paid for telephones used only to originate calls to a limited number of telephone stations for security entry into a building. In addition, the tax does not apply to any amounts paid for rented communication equipment used in the security system.

News services. The tax on toll telephone service and teletypewriter exchange service does not apply to charges for the following news services.

- Services dealing exclusively with the collection or dissemination of news for or through the public press or radio or television broadcasting.
- Services used exclusively in the collection or dissemination of news by a news ticker

service furnishing a general news service similar to that of the public press.

This exemption applies to payments received for messages from one member of the news media to another member (or to or from their bona fide correspondents). For the exemption to apply, the charge for these services must be billed in writing to the person paying for the service and that person must certify in writing that the services are used for an exempt purpose.

Services not exempted. The tax applies to amounts paid by members of the news media for local telephone service. Toll telephone service in connection with celebrities or special guests on talk shows is subject to the tax.

Common carriers and communications companies. The tax on toll telephone service does not apply to WATS (wide area telephone service) used by common carriers, telephone and telegraph companies, or radio broadcasting stations or networks in their business. A common carrier is one holding itself out to the public as engaged in the business of transportation of persons or property for compensation and offering its services to the public generally.

Military personnel serving in a combat zone. The tax on toll telephone services does not apply to telephone calls originating in a combat zone that are made by members of the U.S. Armed Forces serving there if the person receiving payment for the call receives a properly executed exemption certificate. The signed and dated exemption certificate must contain all the following information.

- The name of the member of the U.S. Armed Forces performing services in the combat zone who originated the call.
- The toll charges, point of origin, and name of carrier.
- A statement that the charges are exempt from tax under section 4253(d) of the Internal Revenue Code.
- The name and address of the telephone subscriber.

This exemption also applies to members of the Armed Forces serving in a qualified hazardous duty area. A qualified hazardous duty area includes an area only while the special pay provision is in effect for that area.

For information about areas designated a combat zone or qualified hazardous duty area, see Publication 3, *Armed Forces' Tax Guide*.

International organizations and the American Red Cross. The tax does not apply to communication services furnished to an international organization or to the American National Red Cross.

Nonprofit hospitals. The tax does not apply to telephone services furnished to income tax-exempt nonprofit hospitals for their use. Also, the tax does not apply to amounts paid by these hospitals to provide local telephone service in the homes of their personnel who must be reached during their off-duty hours.

Nonprofit educational organizations. The tax does not apply to payments received for services and facilities furnished to a nonprofit educational organization for its use. A nonprofit

educational organization is one that satisfies all the following requirements.

- It normally maintains a regular faculty and curriculum.
- It normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.
- It is exempt from income tax under section 501(a) of the Internal Revenue Code.

This includes a school operated by an organization exempt under section 501(c)(3) of the Internal Revenue Code if the school meets the above qualifications.

Federal, state, and local government. The tax does not apply to communication services provided to the government of the United States, the government of any state or its political subdivisions, the District of Columbia, or the United Nations. Treat an *Indian tribal government* as a state for the exemption from the communications tax only if the services involve the exercise of an essential tribal government function.

Exemption certificate. Any form of exemption certificate will be acceptable if it includes all the information required by the Internal Revenue Code and Regulations. File the certificate with the provider of the communication services.

The following users that are exempt from the communications tax do not have to file an annual exemption certificate after they have filed the initial certificate to claim an exemption from the communications tax.

- The American National Red Cross and other international organizations.
- Nonprofit hospitals.
- Nonprofit educational organizations.
- State and local governments.

The federal government does not have to file any exemption certificate.

All other organizations must furnish exemption certificates when required.

Credits or Refunds

If tax is collected and paid over for certain services or users exempt from the communications tax:

- 1) The collector may claim a credit or refund if it has:
 - a) Repaid the tax to the person from whom the tax was collected, or
 - b) Obtained the consent of that person to the allowance of the credit or refund, or
- 2) The person who paid the tax may claim a refund.

For information on forms used to claim a credit or refund, see *Credits and Refunds*, later.

Air Transportation Taxes

Taxes are imposed on amounts paid for all the following services.

- Transportation of persons by air.

- Use of international air travel facilities.
- Transportation of property by air.

Transportation of Persons by Air

The tax on transportation of persons by air is made up of the following two parts.

- The percentage tax.
- The domestic-segment tax.

Percentage tax. A tax of 7.5% applies to amounts paid for taxable transportation of persons by air. Amounts paid for transportation include charges for layover or waiting time and movement of aircraft in deadhead service.

Mileage awards. The percentage tax may apply to an amount paid (in cash or in kind) to an air carrier (or any related person) for the right to provide mileage awards for, or other reductions in the cost of, any transportation of persons by air. For example, this applies to mileage awards purchased by credit card companies, telephone companies, restaurants, hotels, and other businesses.

Generally, the percentage tax does not apply to amounts paid for mileage awards where the mileage awards cannot, under any circumstances, be redeemed for air transportation that is subject to the tax. Until regulations are issued, the following rules apply to mileage awards.

- Amounts paid for mileage awards that cannot be redeemed for taxable transportation beginning and ending in the United States are not subject to the tax. For this rule, mileage awards issued by a foreign air carrier are considered to be usable only on that foreign air carrier and thus not redeemable for taxable transportation beginning and ending in the United States. Therefore, amounts paid to a foreign air carrier for mileage awards are not subject to the tax.
- Amounts paid by an air carrier to a domestic air carrier for mileage awards that can be redeemed for taxable transportation are not subject to the tax to the extent those miles will be awarded in connection with the purchase of taxable transportation.
- Amounts paid by an air carrier to a domestic air carrier for mileage awards that can be redeemed for taxable transportation are subject to the tax to the extent those miles will not be awarded in connection with the purchase of taxable transportation.

Domestic-segment tax. The domestic-segment tax is a flat dollar amount for each segment of taxable transportation for which an amount is paid. However, see *Rural airports*, later. A *segment* is a single takeoff and a single landing. The domestic-segment tax is \$3.00 per segment that begins during 2003.

Example. In January 2003, Frank Jones pays \$264 to a commercial airline for a flight in January from Washington to Chicago with an intermediate stop in Cleveland. The flight comprises two segments. The price includes the

\$240 fare and \$24 excise tax $[(\$240 \times 7.5\%) + (2 \times \$3.00)]$ for which Frank is liable. The airline collects the tax from Frank and pays it over to the government.

Charter flights. If an aircraft is chartered, the domestic-segment tax for each segment of taxable transportation is figured by multiplying the tax by the number of passengers transported on the aircraft.

Example. In March 2003, Tim Clark pays \$1,117 to an air charter service to carry 7 employees from Washington to Detroit with an intermediate stop in Pittsburgh. The flight comprises two segments. The price includes the \$1,000 charter payment and \$117 excise tax $[(\$1,000 \times 7.5\%) + (2 \times \$3.00 \times 7 \text{ passengers})]$ for which Tim is liable. The charter service collects the tax from Tim and pays it over to the government.

Rural airports. The domestic-segment tax does not apply to a segment to or from a rural airport. An airport is a rural airport for a calendar year if it satisfies both the following requirements.

- 1) Fewer than 100,000 commercial passengers departed from the airport during the second preceding calendar year.
- 2) Either of the following statements is true.
 - a) The airport is not located within 75 miles of another airport from which 100,000 or more commercial passengers departed during the second preceding calendar year.
 - b) The airport was receiving essential air service subsidies as of August 5, 1997.

Revenue Procedure 98-18 in Cumulative Bulletin 1998-1 is the most recent list of rural airports published by the IRS. An updated list can be found on the Department of Transportation web site at www.bts.gov/cal/rural.html.

Taxable transportation. Taxable transportation is transportation by air that meets either of the following tests.

- It begins and ends either in the United States or at any place in Canada or Mexico not more than 225 miles from the nearest point on the continental United States boundary (this is the *225-mile zone*).
- It is directly or indirectly from one port or station in the United States to another port or station in the United States, but only if it is not a part of uninterrupted international air transportation, discussed later.

Round trip. A round trip is considered two separate trips. The first trip is from the point of departure to the destination. The second trip is the return trip from that destination.

Uninterrupted international air transportation. This means transportation entirely by air that does not begin and end in the United States or in the 225-mile zone if there is not more than a 12-hour scheduled interval between arrival and departure at any station in the United States. For a special rule that applies to military personnel, see *Exemptions from tax*, later.

Transportation between the continental U.S. and Alaska or Hawaii. This transportation is partially exempt from the tax on transportation of persons by air. The tax does not apply to the part of the trip between the point at which the route of transportation leaves or enters the continental United States (or a port or station in the 225-mile zone) and the point at which it enters or leaves Hawaii or Alaska. Leaving or entering occurs when the route of the transportation passes over either the United States border or a point 3 nautical miles (3.45 statute miles) from low tide on the coast line, or when it leaves a port or station in the 225-mile zone. Therefore, this transportation is subject to the percentage tax on the part of the trip in U.S. airspace, the domestic-segment tax for each domestic segment, and the tax on the use of international air travel facilities, discussed later.

Transportation within Alaska or Hawaii. The tax on transportation of persons by air applies to the entire fare paid in the case of flights between any of the Hawaiian Islands, and between any ports or stations in the Aleutian Islands or other ports or stations elsewhere in Alaska. The tax applies even though parts of the flights may be over international waters or over Canada, if no point on the direct line of transportation between the ports or stations is more than 225 miles from the United States (Hawaii or Alaska).

Package tours. The air transportation taxes apply to "complimentary" air transportation furnished solely to participants in package holiday tours. The amount paid for these package tours includes a charge for air transportation even though it may be advertised as "free." This rule also applies to the tax on the use of international air travel facilities, discussed later.

Liability for tax. The person paying for taxable transportation is liable for the tax and, ordinarily, the person receiving the payment collects the tax, files the returns, and pays the tax over to the government. However, if payment is made outside the United States for a prepaid order, exchange order, or similar order, the person furnishing the initial transportation provided for under that order must collect the tax.

A *travel agency* that is an independent broker and sells tours on aircraft that it charters must collect the transportation tax, file the returns, and pay the tax over to the government. However, a travel agency that sells tours as the agent of an airline must collect the tax and remit it to the airline for the filing of returns and for the payment of the tax over to the government.

The fact that the aircraft does not use public or commercial airports in taking off and landing has no effect on the tax. But see *Certain helicopter uses*, later.

For taxable transportation that begins and ends in the United States, the tax applies regardless of whether the payment is made in or outside the United States.

If the tax is not paid when payment for the transportation is made, the air carrier providing the initial segment of the transportation that begins or ends in the United States becomes liable for the tax.

Exemptions from tax. The tax on transportation of persons by air does not apply in the following situations. See also *Special Rules on Transportation Taxes*, later.

Military personnel on international trips. When traveling in uniform at their own expense, United States military personnel on authorized leave are deemed to be traveling in *uninterrupted international air transportation* (defined earlier) even if the scheduled interval between arrival and departure at any station in the United States is actually more than 12 hours. However, such personnel must buy their tickets within 12 hours after landing at the first domestic airport and accept the first available accommodation of the type called for by their tickets. The trip must begin or end outside the United States and the 225-mile zone.

Certain helicopter uses. The tax does not apply to air transportation by helicopter if the helicopter is used for any of the following purposes.

- 1) Transporting individuals, equipment, or supplies in the exploration for, or the development or removal of, hard minerals, oil, or gas.
- 2) Planting, cultivating, cutting, transporting, or caring for trees (including logging operations).
- 3) Providing emergency medical services.

However, during a use described in items (1) and (2), the tax applies if the helicopter takes off from, or lands at, a facility eligible for assistance under the Airport and Airway Development Act of 1970, or otherwise uses services provided under section 44509 or 44913(b) or subchapter I of chapter 471 of title 49, United States Code. For item (1), treat each flight segment as a separate flight.

Fixed-wing air ambulance. The tax does not apply to air transportation by fixed-wing aircraft if used for emergency medical services. The aircraft must be equipped for and exclusively dedicated on that flight to acute care emergency medical services.

Skydiving. The tax does not apply to any air transportation exclusively for the purpose of skydiving.

Bonus tickets. The tax does not apply to free bonus tickets issued by an airline company to its customers who have satisfied all requirements to qualify for the bonus tickets. However, the tax applies to amounts paid by customers for advance bonus tickets when customers have traveled insufficient mileage to fully qualify for the free advance bonus tickets.

Use of International Air Travel Facilities

A \$13.40 tax per person is imposed on amounts paid during 2003 (whether in or outside the United States) for international flights that begin or end in the United States. However, for a domestic segment that begins or ends in Alaska or Hawaii, a \$8.70 tax per person applies only to departures. This tax does not apply if all the transportation is subject to the percentage tax, discussed earlier.

Transportation of Property by Air

A tax of 6.25% is imposed on amounts paid (whether in or outside the United States) for transportation of property by air. The fact that the aircraft may not use public or commercial airports in taking off and landing has no effect on the tax. The tax applies only to amounts paid to a person engaged in the business of transporting property by air for hire.

The tax applies only to transportation (including layover time and movement of aircraft in deadhead service) that *begins and ends* in the United States. Thus, the tax does not apply to transportation of property by air that begins or ends outside the United States.

Exemptions from tax. The tax on transportation of property by air does not apply in the following situations. See also *Special Rules on Transportation Taxes*, later.

Cropdusting and firefighting service. The tax does not apply to amounts paid for cropdusting or aerial firefighting service.

Exportation. The tax does not apply to payments for transportation of property by air in the course of exportation (including to United States possessions) by continuous movement, as evidenced by the execution of Form 1363, *Export Exemption Certificate*. See Form 1363 for more details.

Certain helicopter and fixed-wing air ambulance uses. The tax does not apply to amounts paid for the use of helicopters in construction to set heating and air conditioning units on roofs of buildings, to dismantle tower cranes, and to aid in construction of power lines and ski lifts.

The tax also does not apply to air transportation by helicopter or fixed-wing aircraft for the purpose of providing emergency medical services. The fixed-wing aircraft must be equipped for and exclusively dedicated on that flight to acute care emergency medical services.

Skydiving. The tax does not apply to any air transportation exclusively for the purpose of skydiving.

Excess baggage. The tax does not apply to excess baggage accompanying a passenger on an aircraft operated on an established line.

Alaska and Hawaii. For transportation of property to and from Alaska and Hawaii, the tax in general does not apply to the portion of the transportation that is entirely outside the continental United States (or the 225-mile zone if the aircraft departs from or arrives at an airport in the 225-mile zone). But the tax applies to flights between ports or stations in Alaska and the Aleutian Islands, as well as between ports or stations in Hawaii. The tax applies even though parts of the flights may be over international waters or over Canada, if no point on a line drawn from where the route of transportation leaves the United States (Alaska) to where it reenters the United States (Alaska) is more than 225 miles from the United States.

Liability for tax. The person paying for taxable transportation is liable for the tax and, ordinarily, the person engaged in the business of transporting property by air for hire receives the payment, collects the tax, files the returns, and pays the tax over to the government.

If tax is not paid when a payment is made outside the United States, the person furnishing the last segment of taxable transportation collects the tax from the person to whom the property is delivered in the United States.

Special Rules on Transportation Taxes

In certain circumstances, special rules apply to the taxes on transportation of persons and property by air.

Aircraft used by affiliated corporations. The taxes do not apply to payments received by one member of an affiliated group of corporations from another member for services furnished in connection with the use of an aircraft. However, the aircraft must be owned or leased by a member of the affiliated group and cannot be available for hire by a nonmember of the affiliated group. Determine whether an aircraft is available for hire by a nonmember of an affiliated group on a flight-by-flight basis.

An affiliated group of corporations, for this rule, is any group of corporations connected with a common parent corporation through 80% or more of stock ownership.

Small aircraft. The taxes do not apply to transportation furnished by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less. However, the taxes do apply if the aircraft is operated on an established line. "Operated on an established line" means the aircraft operates with some degree of regularity between definite points.

Consider an aircraft to be operated on an established line if it is operated on a charter basis between two cities also served by that carrier on a regularly scheduled basis.

Mixed load of persons and property. If a single amount is paid for air transportation of persons and property, the payment must be allocated between the amount subject to the tax on transportation of persons and the amount subject to the tax on transportation of property. The allocation must be reasonable and supported by adequate records.

Credits or Refunds

If tax is collected and paid over for air transportation that is not taxable air transportation, the collector may claim a credit or refund if it has repaid the tax to the person from whom the tax was collected or obtained the consent of that person to the allowance of the credit or refund. Alternatively, the person who paid the tax may claim a refund. For information on forms used to claim a credit or refund, see *Credits and Refunds*, later.

Fuel Taxes

Excise taxes are imposed on all the following fuels.

- Gasoline.
- Gasohol.
- Diesel fuel.

Excise Tax/T-100 Report Conversion Form

Because there is no direct correlation between Excise Taxes collected and remitted and the Revenue Passengers and Revenue Freight of a carrier, a carrier should have or quickly be able to create a single form which correlates the information supporting the Excise Tax report with the T-100 report. This report should be able to display for analysis at least the following information for all traffic for which Excise Tax is collected.

1. Date of Transportation
2. Origin Point of Passenger or Freight
3. Destination Point of Freight
4. Revenue or Non-Revenue Status (Check Box or Yes/No)
5. Name of Passenger or Shipper of Freight
6. Ticket or Waybill Number or Identifier
7. Number of Passengers Transported (0 or number of persons on ticket)
8. Actual or Dimensional Weight of Shipment (whichever greater)
9. Fare or Rate Paid for Transportation (excluding taxes)
10. Segment Tax Paid for Passenger
11. 7.5% Tax Paid for Passengers
12. 6.25% Tax Paid for Freight
13. Flight Log Number or Flight Identifier
14. Aircraft Registration Number

All of these data must be collected on one form or another in base data. This form would correlate Revenue Traffic and Excise Taxes paid. For any given period, the sum of all passengers or freight weight in a directional market shown on this form should equal that shown on the T-100 market report. The sum of all excise taxes collected on all traffic, revenue or non-revenue, should equal the amount of taxes collected and remitted.

**Correspondence Relating to Rate Paid
for Service Actually Provided**

The correspondence on the following pages reflects answers from the Department of Transportation to questions about the application of mail pay rates in a situation where a different and lower pay rate could be applied to a bush service. The Department's consistent and unequivocal position is that the Postal Service shall pay the rate for the service actually provided, subject to the ability of any higher rates carrier to equalize to the lowest authorized rate. If mainline service is not actually being provided, then the Postal Service shall pay the bush rate for all mail transported even if an equalization notice had previously be filed when mainline service was actually being provided.

MYERS & COMPANY

SERVICES FOR THE TRANSPORTATION INDUSTRY

P.O. Box 7341, Bellevue, WA 98008 (206) 641-8243

January 11, 1989

Sam Podberesky
Assistant General Counsel for
Aviation Enforcement and Proceedings
Room 4116
Department of Transportation
400 7th Street, SW
Washington, D.C. 20590

Dear Mr. Podberesky:

On behalf of a number of air carriers in Alaska, I am seeking your interpretation of the "equalization" provisions of the intra-Alaska bush mail rate orders. Equalization has been authorized from the time that separate bush and mainline rates were established in 1981. The most recent order addressing equalization, Order 88-4-27, finds that "The carriers should retain the discretion to equalize to the lowest available service mail rate in competitive markets". (emphasis added)

Department and Board orders have always addressed the right of a carrier to equalize rates on a market-by-market basis, and have never considered routing of actual aircraft. This question has been raised by the refusal of the Postal Service to allow equalization, or tender mail to bush carriers unless they operate over an identical routing to the carrier being equalized to. This refusal not only deprives carriers of the rights granted in the mail rate orders, but reduces the actual service in the markets at issue.

The markets at issue typically involve a mail dispatch point and a bush point receiving its only direct service by bush aircraft. A mainline carrier will initiate service between the mail dispatch point and a more distant connecting hub, and then backhaul to the destination by bush aircraft. If the bush destination is closer to the connecting point than the dispatch point, the total rate is often less than the dispatch-to-destination bush rate. Postal Service practice is to tender all mail to the mainline carrier, and refuse to allow bush carriers to equalize to the combination rate in effect.

The Postal Service has explained that it is incapable of allowing bush carriers to equalize to combination rates because the computer program used to generate payments does not allow for equalization to those rates. Such refusal not only deprives the bush carriers of their rightful share of traffic, but means that all mail is carried over a more circuitous and connecting route.

Even more ironic, while the payment program precludes dispatch to direct bush flights, it encourages bush carriers to participate in the circuitous routing on

Sam Podberesky
January 11, 1989

an interline basis. If a bush carrier initiates service between the connecting point and the bush destination, it will receive equitable tender over the route. If it offers direct service between the origin and destination, it gets nothing.

Would you please advise us of your interpretation of the intent and meaning of the equalization provisions of the bush mail rate? Recent changes in Alaska have increased the practice of combination routings to the detriment of direct routings. Your prompt response is appreciated.

Sincerely,

A handwritten signature in dark ink, appearing to read "Hank Myers", with a stylized flourish at the end.

Hank Myers



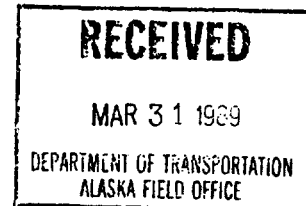
U.S. Department of
Transportation

General Counsel

400 Seventh St. S.W.
Washington D.C. 20590

MAR 27 1989

Mr. Hank Myers
Myers & Company
P.O. Box 7341
Bellevue, Washington 98008



Dear Mr. Myers:

Since this office reviews the legal aspects of the Department's service mail rate functions, Mr. Podberesky, the Assistant General Counsel for Aviation Enforcement and Proceedings, has referred your letter regarding the scope of mail rate equalization authority in Alaska to me for reply. My response reflects the clarifications you made in your second letter, addressed to Mr. Myers of this office.

On behalf of a number of Alaskan air carriers, you have asked whether an alleged refusal by the Postal Service to allow bush aircraft operators to equalize their applicable bush rate with a lower combination of mainline and bush rates over a less direct routing is consistent with the equalization provisions of Order 82-11-108 and subsequent intra-Alaska bush mail rate orders.

In my opinion it is not.

Specifically, you cite a practice of refusing to allow bush aircraft operators providing direct service to a bush point to equalize with a combination rate consisting of mainline service to a connecting hub and bush service to the destination point. Apparently, notwithstanding the additional mileage of the combined service, the lower mainline rate component often results in a lower overall rate to the bush destination point and, in such instances, the Postal Service will not permit the direct service bush aircraft operator to match the lower combination rate because the computer program used to generate payments does not allow for equalization to those rates. You state your belief that such refusal deprives bush carriers of mail traffic access contemplated by the mail rate provisions and discourages direct air service to bush points in favor of more circuitous, connecting service.

A review of the pertinent authority indicates quite clearly that equalization is authorized in such instances, and that the Postal Service must find some way of accommodating properly filed notices of equalization. Order 83-10-28, in particular, contains an extensive discussion of the intended scope of equalization authority within Alaska. In describing the application of that authority, the CAB noted that most mail to bush points moves over both mainline and bush routes:

It originates at a mainline point and moves on large aircraft to a bush hub where it is transferred to a small bush aircraft for carriage to its destination. If there are two different routings available from a mainline point of origin to a bush destination, without equalization authority all mail will move only over the routing which results in the lowest charge to the Postal Service.

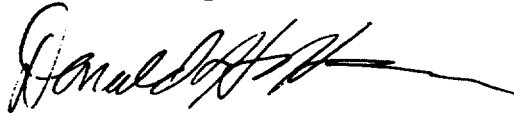
While the equalization in that case involved two combination rates, with the more circuitous combination attempting to match the less circuitous combination to a particular destination point, the Board's focus on the overriding importance of promoting new carriers, new service, and increased routing flexibility between points in Alaska under its "procompetitive mandate" leaves no doubt that the equalization provisions in Order 82-11-108 also authorize the equalization of a bush to a mainline rate or a bush to a combination rate, regardless of connections, routing or mileage. Order 85-7-28 further emphasized this procompetitive thrust by stating that "competing carriers may also equalize on a per-flight basis" and Order 88-4-27 reaffirmed that "the carriers should retain the discretion to equalize to the lowest available service mail rate in competitive markets." For this purpose, a market must be viewed as the true origin and destination of a mail dispatch.

If anything, the CAB's concerns would be even more pertinent where, as here, a refusal to acknowledge equalization rights on its face serves to keep bush carriers attempting to provide direct or less circuitous online service to a bush point from competing with more circuitous interline service for a fair and equitable distribution of the mail traffic to that point.

Finally, in Order 83-10-28, the CAB specifically found that the "adverse competitive consequences" of narrowing or eliminating the equalization authority greatly outweighed the administrative convenience to the Postal Service of being able to reduce the number of service proposals it must evaluate.

I hope this letter is responsive to your legal concerns.

Sincerely,

A handwritten signature in dark ink, appearing to read "Donald H. Horn", with a long, sweeping horizontal stroke extending to the right.

Donald H. Horn
Assistant General Counsel for
International Law

cc: U.S. Postal Service

116069

ORDER 2000-11-9



UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
OFFICE OF THE SECRETARY
WASHINGTON, D.C.

Issued by the Department of Transportation
on the 13th day of November, 2000

Served: November 16, 2000

INTRA-ALASKA MAINLINE

SERVICE MAIL RATES

Docket OST-95-429 -126

(Docket 38961)

ORDER ESTABLISHING FINAL MAINLINE SERVICE MAIL RATES

Summary

By this order the Department is setting new final intra-Alaska mainline mail rates effective October 1, 2000, through September 30, 2001. The rate is based on traffic and costs for the year ended March 31, 2000, except for fuel, where consistent with Order 99-12-15, in response to dramatic fuel price increases, we decided to update the fuel portion of the linehaul quarterly. The rates currently in effect were extended as interim rates by Order 2000-9-27, effective October 1.

The order adopts the costing methodology tentatively established by Order 2000-8-14, but makes several significant adjustments. First, because the quarter ended June 30, 2000, fuel costs have now been reported, we will incorporate them in this order.¹ Next, we are incorporating Northern Air Cargo's (NAC) revised financial numbers. We are also excluding Air Cargo Express's (ACE) linehaul costs from the cost pool because we have now found them to be unreliable. Finally, we will include Lynden Air Cargo's (LAC) linehaul costs.

Background

By Order 2000-8-14 the Department tentatively proposed a methodological change to our annual mainline mail update by weighting linehaul costs by the amount of mail transported by each carrier's aircraft type and terminal costs by the amount of mail each carrier enplanes. In addition, for the first time we tentatively included ACE's costs, terminal and linehaul, because it carries a significant amount of mainline mail. That order tentatively excluded LAC from the cost pool because it found their terminal costs

¹ When the show-cause order issued, we used the quarter ended 3/31/00 fuel costs for illustrative purposes because the June quarter had not yet been reported. Also, those fuel costs were not weighted by amount of

-3-

captures the facilities used in but not necessarily the additional facilities useful for transportation of mail.

Disposition We believe that if assets or facilities are not used for the transportation of mail, there is a presumption against recognizing their costs. We do not recognize any of the cost of operations outside Alaska when setting rates even though such capacity could be readily flown to Alaska and become available if the need arose. Weighting of costs by the frequency and amount of use, the primary issue in this update, is a recognized costing principle and is, as the carriers contend, appropriate in the Alaska mail context. Under the Postal Service's construction, the Department could determine mail rates by ignoring the cost of the aircraft and facilities actually moving the mail and instead recognize the cost of aircraft and facilities that *could* be used to carry mail.⁵

The correct construction of the phrase "used and useful" follows from the conjunction of the two terms. The carriers emphasize the first word in the phrase while the Postal Service emphasizes the last. Because of the conjunction, the word useful constrains the word used. If an asset is used in the transportation of mail but is not useful, its costs should be excluded from determining the rate. This protects the Postal Service. For example, we exclude flight attendant costs from the rate calculation, even though they are used on all of AS' combi-aircraft flights because they are not useful for the movement of mail. More generally, if carriers attempted to manipulate the rate by using assets clearly not useful for moving the mail, we would exclude those costs.⁶ We thus believe that our construction is consistent with the statute.

Weighting by Amount of Mail Carried Discourages Efficiency

The Postal Service repeated its earlier pleadings that weighting carrier costs by mail carried, especially linehaul costs by aircraft-specific RTMs of mail, would encourage carriers to manipulate the rate by using their most expensive aircraft to move the mail, since mail rates would thereby be increased over time. The Postal Service contends that adopting the new methodology would discourage carriers from replacing their older aircraft with more efficient aircraft, especially aircraft designed like the B-737-200 to carry proportionally more mail, because the influx of such new, efficient, mail-friendly aircraft would decrease the overall mail rate more than the current methodology.⁷

⁵ See our discussion of the addition of Express in this order.

⁶ This is a less stringent regulatory standard than the one requiring that only costs incurred by "honest, economical, and efficient" management be recognized. Under the "used and useful standard," costs mistakenly incurred by carriers in good faith would be included in cost calculations; under the "honest, economical and efficient standards" they would be excluded.

⁷ The Postal Service's argument is as follows. B-737-200 combi aircraft currently carry the bulk of AS's mail because of their mail-friendly design. However, due to their age they are becoming increasingly expensive to operate. When deciding whether or not to replace those aircraft with similar but less-expensive-to-operate new aircraft, AS would have less incentive re-equip under the mail-weighting methodology because more mail presumably would continue to be assigned to the new aircraft and their lower costs would be more fully reflected in the rate. The new methodology would make the re-equipment decision more problematic for management.

-4-

The carriers restate some of their earlier arguments. AS already carries the most mail on its higher unit-cost B-737-200 aircraft, not to drive up the mail rate, but because it, unlike the other aircraft types, is "the optimal aircraft to accommodate the combined needs of Alaska's three principal sources of revenue....[and] Alaska's other aircraft lack the belly capacity and adjustable interiors best-suited to transport" ⁸ mail. Among the other carriers, LAC will not be able to manipulate the rate by moving mail on more expensive aircraft because they have only one aircraft type, while ACE has only a single mainline aircraft, other than its fleet of DC-6s. NAC alone has a fleet mix (DC-6s and B-727s) that would theoretically allow it to change its current policy and carry more mail on its higher unit-cost aircraft type and so manipulate the rate. ⁹ The carriers continue to maintain that it would make no sense in the real world for them to intentionally increase the costs they incur individually in the hope that perhaps a year-and-a-half later those costs would be recovered as a rate increase shared among all carriers.

Disposition The Postal Service's arguments against the weighting methodology reflect what it sees as currently expensive service with the prospect of even further cost increases. The Postal Service expects its costs to increase further in the future even without a change in methodology because of increased costs of AS's 737 and NAC's 727 maintenance and inspections due to new FAA-mandated requirements for those aircraft types. DC-6's, B-737-200's, and B-727-100's currently move the bulk of mainline mail but they are old aircraft and will require increasing maintenance. This will only aggravate the current situation where, in 1999, the Postal Service states it paid an average of \$967 to move a ton of mail 463 miles in Alaska but only \$665 in the lower 48 to move it an average of 1,320 miles.

The Postal Service in its objection on September 22 did not respond to the several theoretical difficulties raised in the order militating against carriers' manipulating the rate for their gain, i.e., a carrier manipulating its costs would directly and immediately ¹⁰ bear those costs by itself but would share the resulting rate increase, after a lag, with all other parties moving that category of mail. In addition, historically AS has moved the bulk of its mail on its higher unit-cost aircraft, the B-737-200, because its belly capacity and adjustable interiors make it the optimal choice for carrying mail, not to increase the reimbursement rate in the future.

The Postal Service modified its position slightly. It argues that adopting the new costing methodology might discourage carriers from readily replacing their older, more expensive aircraft. ¹¹ Whatever the theoretical merits of this more refined position, it is the

⁸ Carriers' joint reply, September 29, 2000, page 9.

⁹ NAC's position is the opposite of AS in that Alaska currently carries most of its mail on its highest cost aircraft in the face of a costing methodology that does not weight for this effect.

¹⁰ The carriers point out that the mail rate may recognize cost increases initially borne by the carriers after up to a 18-month lag.

¹¹ If the Postal Service in fact begins to modify its equitable tender policy to tender more mail to the least costly aircraft operator, there would clearly be an enhanced incentive for a carrier to buy new, cheaper aircraft, because it would thereby garner a greater share of the mail.

-5-

Department's responsibility in setting mail rates to fairly compensate the carriers for the current cost of moving the mail. ¹² To not weight carrier costs by mail carried would ignore the greater cost of AS's B-737-200 equipment compared to its other less expensive jets that carry relatively little mail. The B-737-200 is the only combi-jet aircraft in operation designed for moving large volumes of passengers, mail, and freight. Moreover, although incentives to re-equip might be slightly diminished under the proposed change, real incentives would remain, because although mail is an important part of intra-Alaska traffic, it is far from the only part, at least for most carriers. Carriers that re-equipped and flew aircraft with lower unit costs ¹³ could lower passenger or cargo yields below levels that operators of older equipment could not match.

Carrier's Reported Costs Were Overstated

The Postal Service also felt that the cost increases experienced by NAC and AS were unreasonably high compared to the prior period. It noted that NAC's DC-6 unit cost per ATM were 50% greater than ACE's, and that NAC's B-727 unit costs had increased 58.5% from those in the preceding period.

Disposition As the carriers have stated, NAC has submitted revised data, with its costs substantially below previous levels, such that its non-fuel linehaul costs decrease by 20.9% for its B-727-100 and 9.3% for its DC-6s from those previously reported. The Postal Service's concern with NAC's reported costs were based partly on comparing their costs to ACE's much lower costs. ACE's reporting is currently being reviewed on-site by our Alaska Inspector. Although it is at least several months until the review can be completed, our inspector informs us that ACE greatly understated its maintenance expense because it only included maintenance labor expense in that account. When this correction is made, it is likely that NAC's and ACE's non-fuel linehaul costs will be more comparable, as their fuel and terminal unit costs are already. We have closely reviewed AS's linehaul expenses and it is clear that the increase in expense from the prior period is in the maintenance expense area, as the carrier had indicated, where maintenance costs per hour for its B-737-200s for the year ended March 31, 2000, increased 26.6% from the year before, while unit costs per hour for other non-fuel linehaul expenses actually decreased by 1.5% from the prior year. We anticipate that AS's total unit costs will not diminish significantly in the next annual update, notwithstanding the fewer number of D Checks it projects, as the carrier continues to work with the FAA to resolve some maintenance issues. For NAC, after the revisions made by the carrier, there were modest increases in hourly costs for the DC-6 of 3.5% from the prior year, while B-727-100 unit costs still increased by 25.4% from the prior year. In fact, as can be seen from Appendix C, NAC's B-727's unit cost per ATM for its non-fuel linehaul now exceeds that for its DC-6s.

¹² We also have a responsibility to ensure that appropriate incentives are in place. We continue to believe they are with the new weighting methodology. While under the class-rate system the entry of new, less expensive aircraft drives costs and subsequently rates down, arguably reducing somewhat the incentive to be efficient, in a free market when carriers buy new aircraft they also put pressure on prices with their reduced costs.

¹³ All other things being equal, the savings associated with the new aircraft's decreased maintenance and fuel costs would have to exceed the increased ownership costs of the new aircraft.

Special Cost Studies for Rate Development

It is suggested that the Bush Mail Rate be a multi-element rate consisting of a line-haul charge that varies with distance hauled, and a terminal charge based on weight (number of pounds) enplaned. The initial linehaul rate shall be based on the percentage of linehaul (direct) expenses allocated to the transportation of mail for all carriers and aircraft covered by a specific rate, and divided by the number of revenue ton miles of mail transported under that class by those carriers. Adjustment of linehaul rates would be calculated on the net change in cost per revenue ton mile of traffic transported by the carriers covered by the rate. Terminal charges would be based on the percentage of terminal (indirect) expenses allocated to the handling of mail for all carriers covered by the rate divided by the number of mail pounds enplaned. Adjustment of terminal charges would be based on the net change in cost per revenue ton enplaned by the carriers covered by the rate.

For both linehaul and terminal charges, the cost pools shall consist of three parts. All costs that are not required in order to transport or qualify for tender of mail shall be excluded from consideration. All costs directly related only to the handling or transportation of mail, or in meeting requirements of the Postal Service with no benefit to other classes of traffic shall be paid entirely through mail rates. These rates shall be allocated on the basis of cost per revenue ton mile or pound enplaned as appropriate. All other costs shall be allocated as described above.

The costs specifically allocated for payment entirely by the Postal Service shall include, but not be limited to, the cost of landings and takeoffs made at points where no traffic was deplaned or enplaned so that the carrier could exhibit an adherence to schedule, the costs of having and maintaining a mail holding facility meeting the requirements of the Postal Service where only mail is held and handled, any special facility costs related to the provisions of the PO-508 not required for other classes of traffic, the cost of bush agents whose only responsibility and whose rate of pay is based on the handling and delivery of mail, the cost of any special reports or recordkeeping related solely to compliance with 39USC5402, and any other cost which can be shown would not have occurred but for the requirements to transport mail alone.

The special studies to be performed by all or a representative sample of air carriers should include:

1. The number of takeoffs and landings and the incremental time taken to serve a point on a flight where no revenue traffic of any sort was deplaned or enplaned so that the carrier could meet the requirements of the Postal Service to adhere to the carrier's schedule.

2. All expenses associated with a facility having the sole purpose of storing or protecting mail to the exclusion of other classes of traffic (freight, passengers, baggage)
3. All expenses associated with employees or agents whose sole responsibility and basis of employment is handling or transportation of mail, and whose pay is based at least in part on the volume of mail handled or transported.
4. Calculation and proration of all traffic on flights departing from a mail hub (away from the direction of the hub) weighted by the loading priority assigned to the class of traffic.

**Selected Pages from Presentation by
U.S. Postal Service on Non-Bypass
Mail Tender Procedures**

The following pages are from a presentation made by the U.S. Postal Service to bush air carriers at a meeting held on May 15, 2003 in Juneau, AK. In that presentation, the Postal Service announced that it would apply the criteria specified for the tender and distribution of bypass mail to the tender and distribution of non-bypass mail, including the requirement for maintaining a specific market share of passenger or freight traffic.

The Postal Service makes no differentiation in the presentation between carriers or markets in which bypass mail is carried, and those markets where no bypass is carried. The presentation refers to "All Carriers" when describing the eligibility requirements for tender, and establishes the three mail pools in all markets and at all hubs.

RURAL SERVICE IMPROVEMENT ACT OF 2002



SAIMS-AK DISPATCH
SYSTEM





RURAL SERVICE IMPROVEMENT ACT OF 2002

■ Origin of Legislation

- Introduced to Congress by Senator Stevens
November 15, 2001
- Signed into law on August 2, 2002

■ Purpose of Law Change

- To ensure passenger service and improve passenger safety
 - To support non-mail freight service to rural communities
 - To ensure that bypass system remains viable and affordable for the Postal Service
-



RURAL SERVICE IMPROVEMENT ACT OF 2002

Existing mainline carriers

- certificated under Part 121
- actually transporting bypass mail 1/1/01

■ All carriers

- certificate of public convenience and necessity - 41102(a) of Title 49 USC
- operate at least 3 flights a week to such point
- exhibit an adherence to such scheduled flights
- provided 3 scheduled flights per week between two points within Alaska for at least 12 consecutive months with aircraft--
 - up to 7,500 lbs payload capacity
 - over 7,500 lbs payload capacity

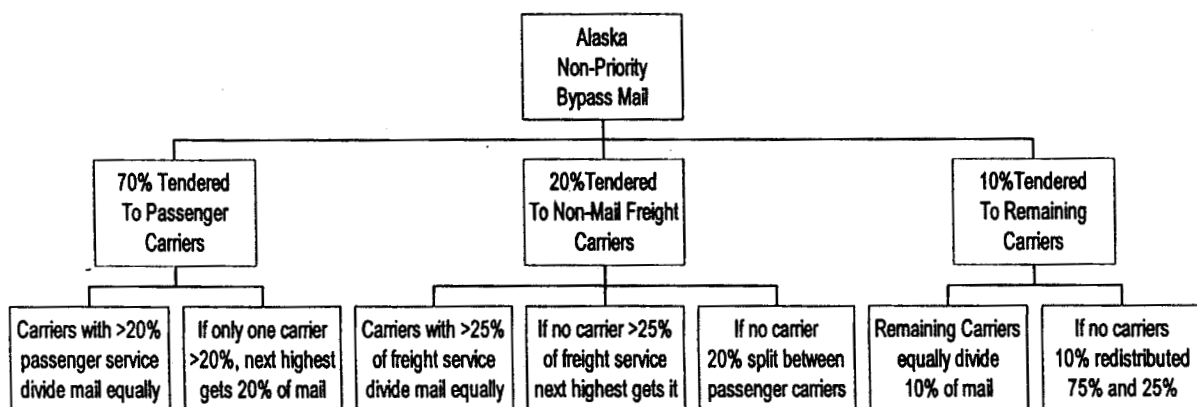


RURAL SERVICE IMPROVEMENT ACT OF 2002

- **Equitable Tender Pools**
- **On a given city pair route, the Postal Service shall offer equitable tender to qualified carriers based on the following tiered approach:**
 - **70% of mail on a given city pair route is divided equally between carriers who operated at least 20% of passenger service (h)(1)**
 - **20% of mail on a given city pair route is divided equally between carriers who operated at least 25% of freight service (i)(1)**
 - **10% of mail on a given city pair route is divided equally between carriers who do not qualify for tender in the tiers above (j)(1)**



RURAL SERVICE IMPROVEMENT ACT OF 2002



Three years and three months after enactment the pools will become 75% and 25%.



RURAL SERVICE IMPROVEMENT ACT OF 2002

■ Hubs

Kodiak	King Salmon	Aniak
Bethel	Barrow	Cold Bay
Dillingham	Dutch Harbor	Emmonak
Fairbanks	Fort Yukon	Galena
Iliamna	Juneau	St. Marys
Ketchikan	McGrath	Nome
Kotzebue	Sitka	Unalakleet

Proposed PO-508 Changes

At the annual convention of the Alaska Air Carriers Association in February, 2003, the Postal Service announced immediate implementation of the changes in the PO-508 shown below, and stated that there would be a complete rewriting of the Procedures Manual before November 3, 2003. No copy of the manual with the new changes already made has been made to the air carriers or other interested parties.

Transmittal Changes to the PO-508 (Distributed 2/27/2003 at A.A.C.A. Convention)
Effective Immediately

1-3.2 Minimum Requirements (p. 2)

Replace the entire section with the following.

The following are the minimum requirements for a carrier to be eligible to carry bypass mail:

- a. hold a certificate of public convenience and necessity issued under section 49 USC 41102 (a);
- b. operate at least 3 scheduled flights each week to any destination point;
- c. exhibit an adherence to such scheduled flights; and
- d. have provided scheduled service with at least 3 scheduled (non-contract) flights per week between two points within the State of Alaska for at least 12 consecutive months with aircraft—
 - (i) up to 7,500 pounds payload capacity before being selected as a carrier of nonpriority bypass mail at an applicable intra-Alaska bush service mail rate.
 - (ii) up to 7,500 pounds payload capacity before being selected as a carrier of nonpriority bypass mail at the intra-Alaska mainline service mail rate.

1-3.2.1 Schedule Adherence (new section p.2)

A carrier exhibits adherence to a schedule by operating that schedule for each one-week period. Carriers that fail to maintain their scheduled weekly frequencies within a market without a satisfactory explanation will lose tender in that market for one month for a first offense, for six months for a second offense in a market and for 1 year for a third offense in a market.

1-3.2.2 Exceptions (new section p. 2)

The Postal Service may select a carrier other than an existing mainline carrier for mail tender if the Postal Service determines that the mail service provided by existing mainline carriers remains deficient after it has notified the carriers in writing and has allowed a 30-day correction period. (See section 6-2.4.2.4 Non-Beneficial Service)

2-3.4.2 Equalization of Rates (p. 5)

Equalization occurs when a carrier using bush aircraft between an origin and a destination files with the DOT a notice of intent to equalize. By making that filing, the equalizing carrier accepts the lowest existing rate of pay in the market.

A composite rate (see Appendix F) is paid to an equalized bush carrier for a direct flight from an acceptance point to a bush destination beyond a hub point, if the result will be no degradation of passenger, freight, and/or mail service in and out of the hub. This rate is based on the mainline linehaul rate paid to the hub plus the lowest bush linehaul rate paid in the State of Alaska for the distance traveled from the hub point to the destination point. A single origin terminal handling is paid at the mainline terminal handling rate.

2-3.5.1 General (p. 6)

The Postal Service determines whether it will utilize equalized service for the transport of in-house non Priority Mail and Priority Mail. Upon receipt of a notice of intent to equalize from the DOT, the Postal Service reviews the service and cost impacts associated with the equalized service using the guidelines below.

2-3.5.1.1 Equalization on Mainline Routes (new section p. 6)

In order to receive equitable tender of bypass mail on a route between an acceptance point and a hub or between an acceptance point and a final destination in which a mainline carrier begins service, a carrier must qualify under 1-3.2 (Minimum Requirements) and have provided for the past six months, and continue to provide, at least 20 percent of the passenger service.

In order to receive equitable tender of bypass mail on a route between a hub and a final destination in which a mainline carrier begins service, a carrier must qualify under 1-3.2 (Minimum Requirements) and a) if a bush passenger carrier, have provided for the past six months, and continue to provide, at least 20 percent of the passenger service or b) if a nonmail freight carrier, have provided for the past six months, and continue to provide, at least 25 percent of the nonmail freight service for the past six months.

Continuity of service for this purpose will be measured in three-month increments beginning on January 1, April 1, July 1, and October 1. Carriers first becoming eligible

(that is, eligible for bypass mail after the six months) will be placed into the normal quarterly evaluation at the next opportunity.

2-3.5.2.3 Capacity (p. 6)

Delete Note in its entirety.

2-3.5.3 Cost Implications (p.2)

Replace current language in entirety with the following.

The Postal Service will consider the operational, administrative, and other indirect costs in addition to the service factors in 2-3.5.2.

3-2.1 Transportation of Mail (p. 9)

Substitute the following for section a)

- a. Adhere to their scheduled service as submitted to the Official Airline Guide (OAG). (See 3-2.3). Scheduled service means:
- b. Flights are operated in common carriage available to the general public under a published schedule;
- c. flight schedules are announced in advance in systems specified by the Postal Service, in addition to the Official Airline Guide or the air cargo equivalent of that Guide;
- d. flights depart whenever passengers, freight, or mail are available in any number or quantity for a flight; and
- e. customers contract for carriage separately on a regular basis.

The Postal Service requires that published flight schedules be adhered to unless no mail has been tendered within the defined tender time limitations prior to the flight departure on the day of the flight.

m. Submit all forms, reports, or mail-related information as required by the Postal Service and the Department of Transportation. The information required includes, but is not limited to, the filed schedules, added schedules, schedule performance, pounds of Priority and non-Priority mail, and aircraft tail number for each trip flown. Carriers that submit late, inaccurate, or no data will lost tender of mail until the data requirements have been met.

3-2.8 Code Share (replace NASS Conversion p. 12)

Carriers operating under a code share agreement must (for the purposes of mail only) convert and display in the OAG the code of the carrier who actually transports the mail. Carriers will be evaluated for tender based on the identity and certification of the carrier who transports the mail.

6-2.1.2.1 Types of Mail (p. 26)

Add to current section...

Non-priority service mail consists of bypass mail (see Chapter 8) and in-house non-priority mail.

6-2.4.1.1 Fair and Reasonable Division (p. 28)

Replace current paragraph with the following.

When two or more carriers in the same passenger or non-mail freight distribution pool established pursuant to 39 USC 5402 (h) and (i) (see Appendix 1) serve the same point with equivalent service in terms of requirements and cost, the mail is distributed equitably between the carriers. Equitable distribution requires a fair and reasonable — but not necessarily equal — division of mail between such carriers.

Notwithstanding the forgoing, the Postal Service retains the right to dispatch in-house non-priority mail using methods it determines sensible to maintain efficiencies and service, control costs, and to promote competition. See also 2-5 concerning equalization.

6-2.4.1.2 Distribution Pools (p. 28)

Add this new section and renumber following sections.

Initial entry and classification into distribution pools will be determined by the preceding 12 months of data (see Appendix I). After the initial classification, the Postal Service will recalculate these pools quarterly, starting at the beginning of the calendar. Carriers that enter a market during a quarterly period, shall have their status evaluated in a market after they complete their term of eligibility using the time frame coinciding with their actual entry in the market. After the initial evaluation, carriers will be evaluated on the quarterly calendar.

6-2.4.1.2 Favorable Pay Rate (p. 28)

Renumber as 6-2.4.1.3 and replace current paragraph with the following.

In competitive situations, the Postal Service considers two additional factors, direct and indirect costs. Direct costs mean the actual rate paid to the carrier by the Postal Service.

Indirect costs include: indirect impact on the class rate, administrative costs, and mail processing costs. In these situations, the dispatch of the mail to the carriers causing less impact on costs is justified because of the more favorable pay rate to the Postal Service. Any evaluation of a carrier's service will include the cost of that service to the Postal Service as compared to alternative modes of transportation.

6-2.4.2.4 Non-Beneficial Service (p. 31)

Add a new paragraph after the existing one.

Deficient service occurs when: a) within two consecutive weeks less than 100% of the mail tendered is delivered to the destination/interline carrier within the transit window; b) service performance is erratic

during any 30-day period, or c) at any time mail is transferred to another carrier with the result that the mail is not transported within the original transit window. (See section 1-3.2.1 Exceptions)

Appendix F- (p. 75)

Add:

Available passenger seats — seats that are installed, insured, and offered for sale to the public.

Composite rate (replace):

Composite rate (replace) — The rate paid to an equalized bush carrier who flies from an acceptance point directly to a bush point. The rate is based on the mainline linehaul rate paid to the hub, plus the lowest bush linehaul rate paid to bush carriers in the State of Alaska for the distance traveled from the hub point to the destination point. A single origin terminal handling is paid at the mainline terminal handling rate.

Equalized rates (replace):

Equalized rates — Rates that apply when an air carrier using bush aircraft and being compensated at a higher rate elects to equalize to the lowest rate in a market or a composite rate.

Add:

In-house non-priority mail — Non-priority mail other than bypass mail.

Add:

Nonscheduled service — Services pursuant to the charter or hiring of aircraft, other revenue services not constituting an integral part of services performed pursuant to published schedules, and related nonrevenue flights.